

Manitoba
June, 2004

OFFICE OF THE
AUDITOR GENERAL

Investigation of Hydra House Ltd.
and
**A Review of the Related Department of
Family Services and Housing Financial
Accountability Framework**

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June 2004

The Honourable George Hickes

Speaker of the House
Room 244, Legislative Building
Winnipeg, Manitoba
R3C 0V8

Dear Sir:

I have the honour to transmit herewith my report on the *Investigation of Hydra House Ltd. and A Review of the Related Department of Family Services and Housing Financial Accountability Framework* to be laid before Members of the Legislative Assembly in accordance with the provisions of Section 28 of The Auditor General Act.

Respectfully submitted,

Jon W. Singleton, CA•CISA
Auditor General

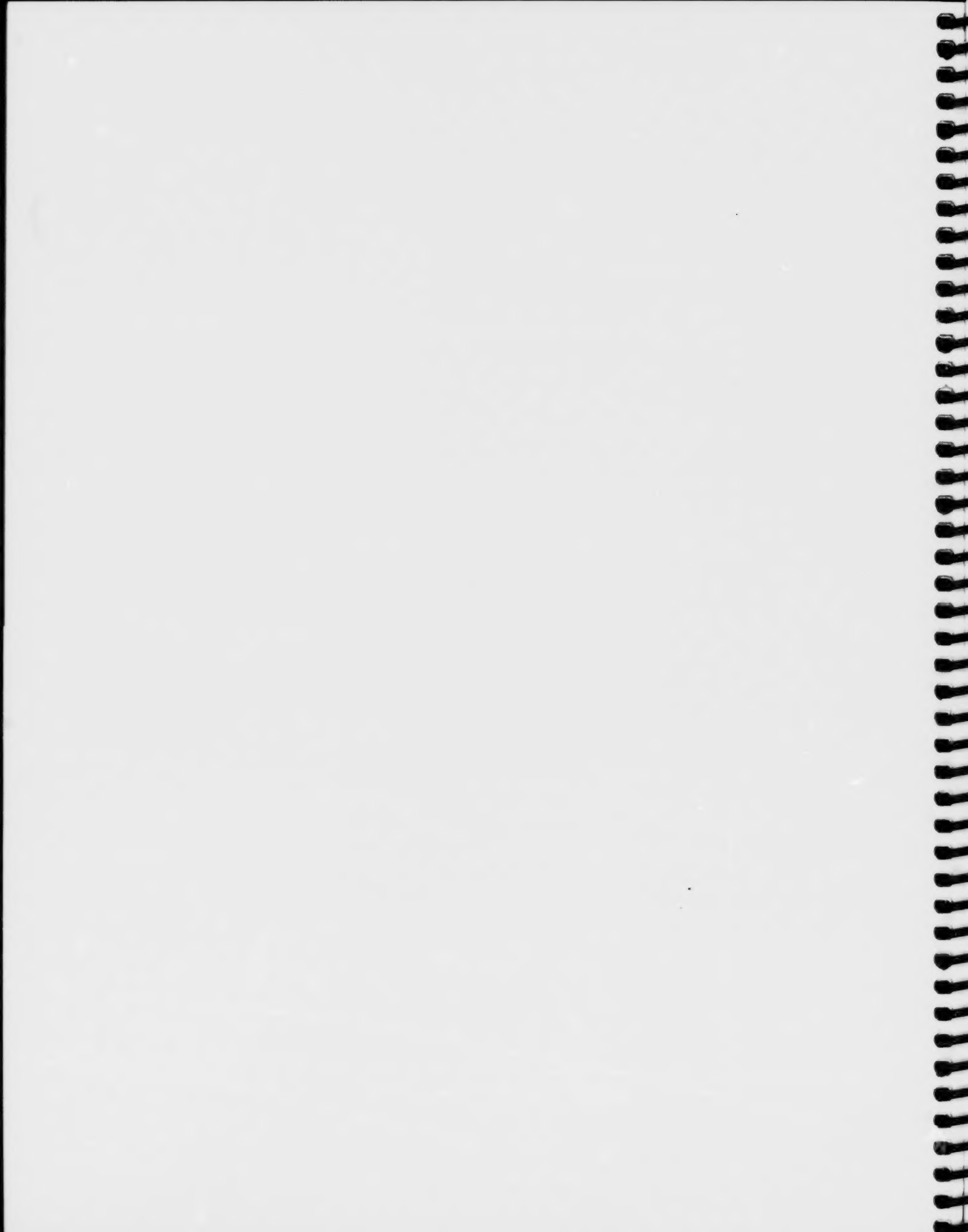


TABLE OF CONTENTS

REFLECTIONS OF THE AUDITOR GENERAL	1
EXECUTIVE SUMMARY	3
1.0 INTRODUCTION	13
1.1 Request	13
1.2 Scope	13
2.0 BACKGROUND	15
2.1 Hydra House Ltd.	15
2.2 Hydra Funding	16
2.3 Hydra Operating Results	17
2.4 Government Funding	18
2.5 Department Structure	18
2.6 Winnipeg Child and Family Services	21
2.7 Winnipeg Regional Health Authority	21
2.8 Applicable Legislation	21
 PART I - HYDRA ALLEGATIONS	
3.0 ALLEGATIONS	23
3.1 Executive Salaries and Other Payments	23
3.2 Use of Public Monies by Executives	27
3.3 Personal Acquaintances and Related Party Transactions	35
3.4 Hydra Financial Position as at March 31, 2002	38
4.0 SPECIFIC ISSUES CONCERNING DEPARTMENT FUNDING OF HYDRA	39
4.1 Deficit Relief Funding Provided to Hydra for the Year Ending March 31, 2002 When Hydra Achieved A Year End Surplus	39
4.2 Per Diem Funding for Vacant Spaces/Downsizing	41
4.3 Funding of 7 th Placements at Hydra Children's Facilities	43

TABLE OF CONTENTS

(cont'd.)

RESPONSE FROM HYDRA HOUSE LTD.	44
-------------------------------------	----

PART II - DEPARTMENT FINANCIAL ACCOUNTABILITY FRAMEWORK

5.0 REVIEW OF THE DEPARTMENT OF FAMILY SERVICES AND HOUSING'S FINANCIAL ACCOUNTABILITY RELATIONSHIP WITH EXTERNAL SERVICE PROVIDERS ..	45
--	----

5.1 External Service Provider Financial Accountability	45
--	----

5.2 Per Diem Funding Models	48
-----------------------------------	----

5.3 External Service Provider Reporting Requirements and Department Analytical Review Procedures	51
---	----

5.4 Comparison of Not-For-Profit and For-Profit External Service Provider Financial Accountability Requirements	54
--	----

5.5 Basis of Accounting and Reporting Requirements for External Service Providers	55
--	----

5.6 External Service Providers with Multiple Sources of Public Funding	56
---	----

6.0 RECOMMENDATIONS	58
---------------------------	----

7.0 LEARNING FOR CIVIL SERVANTS	60
---------------------------------------	----

RESPONSE FROM DEPARTMENT	61
--------------------------------	----

APPENDICES

Governments often look to the not-for-profit or for-profit sectors to act as the provider of services on their behalf. This is the case for the Department of Family Services and Housing. Having an appropriate financial accountability framework in place is essential to ensure that external service providers are using public monies appropriately and for the purposes intended.

The results of our investigation of Hydra House Ltd. (Hydra), highlighted in Part I of my report, illustrate the risks to public monies that can occur when external service providers, whether they are for-profit or not-for-profit, operate in the absence of an appropriate accountability framework. Certain costs and the extent of other costs, incurred by Hydra and charged to its programs, were of a nature or extent not anticipated to be necessary by the Province when it established its funding formula. When Hydra incurred these costs, it reduced the monies available to be applied directly to client care.

I believe that both for-profit and not-for-profit entities have a special duty of care when entrusted with the administration of public monies. This special duty of care requires using public monies with transparency, due diligence and with an appreciation of the accountability to government and citizens. Hydra's sole source of revenue is from the public sector; therefore Hydra is economically dependent on the government to continue to operate. As a result, it was incumbent on Hydra to have been particularly prudent in the use of these monies.

In Part II of this report we identify a number of key elements which we believe are essential for the Department to have in place, for an effective financial accountability framework. Our findings in this area indicated a number of deficiencies and, as a result, in our opinion, the Department was not measuring the performance of its external service providers as effectively as it could have. As a result, they did not have all the information necessary to assess whether external service providers were spending public monies appropriately and for the purposes intended. Also, it is important to consider that the role of civil servants to ensure public monies are being directed toward the provision of public services can be compromised when resources within the Civil Service itself are constrained.

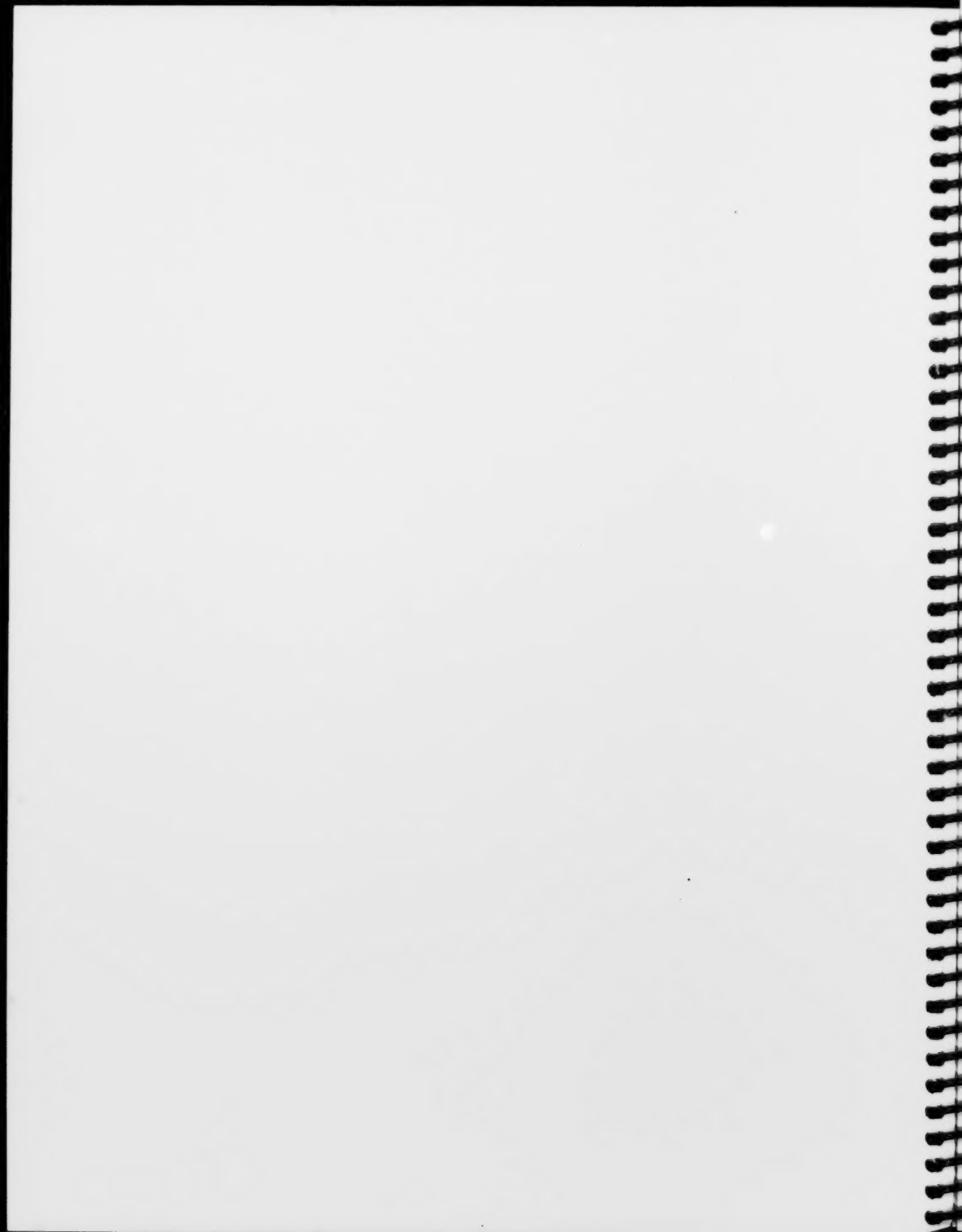
I am pleased that both Hydra and the Department have accepted the report and are working toward resolving the issues raised in both Part I and Part II in a responsive manner.

I hope that the government will examine all instances in which it uses external agencies to deliver public services to assess whether it has put in place, and resourced, an appropriate accountability framework to protect the public interest.



Jon W. Singleton, CA•CISA





Executive Summary

The Office of the Auditor General (OAG) reviewed a number of allegations concerning the operations of Hydra House Ltd. (Hydra), a recipient of public monies. Hydra is a for-profit, privately owned corporation that is economically dependent on provincial funding.

These allegations highlighted issues of:

- Hydra executive salaries/bonuses higher than the norm for other organizations providing similar services;
- Inappropriate use of public monies for personal purposes by Hydra executives;
- Payments to personal acquaintances of the owner of Hydra where there was no visible function of these persons within the organization; and
- Accumulation of surplus monies sourced from public funding.

On June 18, 2003, letters were provided to the owner of Hydra and to the Deputy Minister of the Department of Family Services and Housing (Department) confirming that the OAG planned to investigate these allegations. Section 15(1) of The Auditor General Act permits the Auditor General to perform an examination and audit in respect of a recipient of public money.

Section 10(2)(d) of The Auditor General Act indicates that the Auditor General must bring to the attention of the Legislative Assembly any instances where public money was expended for purposes other than those for which it was appropriated by the Legislature. It should be noted, that the allegations specifically highlighted the inappropriate use of public monies. The allegations did not highlight concerns regarding the quality of residential care. Our concerns with the allegations were that if proven true, such spending could have inappropriately reduced public monies available to provide additional, direct client care services in Manitoba.

In addition to our investigation of the allegations, we reviewed the Department's financial accountability relationship with external service providers.

Our investigation did not include an assessment of the quality of care provided by Hydra.

PART I – HYDRA ALLEGATIONS

A goal of the public sector when providing funding should be to ensure that public monies are substantially used for the purposes intended, which in Hydra's case was to provide for the direct care and maintenance of the children and adults under its care. Our report highlights a number of instances where monies were not used to provide direct care and maintenance. Some examples include:

- The payment of salaries, bonuses, and consulting fees in excess of \$3.8 million, over a six year period, to up to four Hydra executive positions, and the personal assistant to the owner;

- Personal related expenses and significant meal and entertainment charges incurred mainly by current and former Hydra executive on their corporate credit cards;
- The costs incurred by Hydra to maintain a work location in Florida;
- Donations in excess of \$19,000 made to a Winnipeg private high school;
- An unsecured, non-interest bearing loan of approximately \$67,000 was advanced to an arm's length company;
- The purchase of furniture, appliances and other equipment for personal purposes of Hydra staff, mainly the owner;
- The purchase of two Cadillac vehicles for the use of the owner and the personal assistant to the owner;
- The lease of an Audi vehicle for the use of a former Hydra executive member; and
- The Department providing funding of over \$50,000 for a portion of Hydra's operations, that was in a deficit situation, while in the same period Hydra recorded \$180,000 of consulting fees payable to the owner to reduce its reported operating surplus in order to take advantage of a lower corporate income tax rate.

These examples and other items identified in our report, emphasize the need for the Department to improve its financial monitoring procedures when using the services of external service providers, whether they are for-profit or not-for-profit entities. When for-profit external service providers are involved, the Department has to ensure it is receiving complete and appropriate information on a timely basis to facilitate decision making and to ensure that all funded external service providers are equitably funded and monitored.

Hydra's primary source of revenue is from the government, therefore Hydra is economically dependent on the government to continue to operate, a fact which is disclosed on Hydra's audited financial statements each year. Therefore, it was incumbent that Hydra, with access to public monies, should have been particularly prudent in managing the use of these monies.

PART II – DEPARTMENT FINANCIAL ACCOUNTABILITY FRAMEWORK

Although external service providers deliver services on behalf of the Department, ultimately the responsibility for the nature and quality of services provided remains with the Department. For the year ending March 31, 2002 the Department distributed \$54.8 million through the Adult Services Branch (ASB), Winnipeg Region and Child Protection and Support Services (CPSS) to external service providers that operate residential care facilities for children and adults. Therefore, it is imperative that the Department has an effective financial accountability framework to ensure external service providers are both providing quality service and using public monies directly for the purposes intended. Essential elements of an effective financial accountability framework include:

- negotiation and signing of service purchase agreements (SPAs) between the Department and its external service providers;
- current and precise per diem funding models (Section 5.2);
- appropriate financial reporting by external service providers; and
- effective analytical review procedures performed by the Department on the financial reports prepared by external service providers.

In summary, we found that SPAs were not in place with the majority of the external service providers, per diem funding models used in the Department were not current or precise, many of the financial reports requested by the Department from external service providers were not being provided, and the Department's analytical review procedures were not adequate in all instances. As a result of these deficiencies, in our opinion, the Department was not effectively measuring the performance of its external service providers and was not in a position to determine whether external service providers were spending public monies for the purposes intended.

An effective financial accountability framework is important when a for-profit external service provider, such as Hydra, is providing services on behalf of the Department. The risk of public funds being expended for purposes other than the delivery of social services is increased where there is no formal SPA in place, where there is no agreed upon understanding between the parties of how surplus and deficit situations should be addressed, and where there are no salary reporting requirements for the for-profit external service providers.

SUMMARY OF CONCLUSIONS

Investigation of Allegations (Section 3.0)

Allegations

Hydra executive salaries/bonuses higher than the norm for other organizations providing similar services (Section 3.1)

Conclusions

- We estimate that the salaries paid to Hydra executives over six years were approximately \$1.4 million (58%) higher than would have been paid had the programs been operated by not-for-profit external service providers. As there is no documented rationale in the Province's funding formula for these higher costs, it is impossible to judge whether they are appropriate.
- By not preparing combined administrative costs, including the executive salaries, on a separate statement or at least disclosing the extent of the administrative costs contained within each Program statement, readers of these statements did not have the necessary information to determine what the actual direct costs were to operate the various Programs. Had the Department formally requested and received a separate

Investigation of Allegations (Section 3.0)

Allegations

That there was inappropriate use of public monies for personal purposes by Hydra executives. (Section 3.2)

Conclusions

statement of Hydra's administration and central support costs, the Department may have become aware of the fact that executive salaries and bonuses were significantly higher than in not-for-profit external service providers.

- By not including all remuneration paid to its employees in the years 1998, 1999 and 2000 on the T4 information slips, Hydra was not in compliance with The Income Tax Act of Canada.
- We are concerned with the identifiable extent of public monies used for meal and entertainment charges (\$101,800) and other personal expenses of Hydra executive and staff (\$46,400) for the period March 31, 1998 to March 31, 2002, and not used for the direct care and maintenance of the residents. As a result of limited documentation provided for our review, we are unable to definitively quantify the extent. As there is no documented rationale in the Province's funding formula for the incurrence of these types of costs, it is impossible to judge whether they are appropriate.
- It is misleading to include executive and senior management meal and entertainment costs in a category of "program care costs" in financial statements provided to the Department. Funders of these programs may be assuming that all care costs are directly incurred for the benefit of residents.
- The practice of not retaining supporting documentation for corporate credit card expenditures, and the lack of any formal review and approval of these transactions is inappropriate and demonstrates a lack of due care over the management of public monies. Given that the Department has combined rights under The Child and Family Services Act and The Vulnerable Persons Living With a Mental Disability Act to review accounting and other records of external service providers, Hydra has not complied with the intent of these Acts that financial accountability documentation be maintained.

Investigation of Allegations (Section 3.0)

Allegations

That payments were made to personal acquaintances of the owner of Hydra where there was no visible function of these persons within the organization. (Section 3.3)

Conclusions

- By not including all taxable benefits for its employees on the T4 information slips prepared for income tax purposes Hydra was not in compliance with The Income Tax Act of Canada.
- We estimate that approximately \$98,200 of expenditures over five years appear to be of a personal nature, or was unusual given the nature of Hydra's operations, and was not used for the direct care and maintenance of the residents. As a result of limited documentation provided for our review, we are unable to definitively quantify the extent. As there is no documented rationale in the Province's funding formula for these higher costs, it is impossible to judge whether they are appropriate.
- A property sale transaction, from the owner to Hydra, was not recorded in an open and transparent manner.
- Hydra appears either not to have received appropriate compensation, for the sale of vehicles to the owner and the personal assistant to the owner, or alternatively, declared a taxable benefit for the transaction.
- In our opinion, the salary amounts paid to the personal assistant were not reasonable in relation to the duties performed.
- The salary of the personal assistant and the costs incurred to provide the personal assistant with office equipment and supplies for two locations, separate from the main office of Hydra, appear to be an unnecessary expense especially when considering that public monies which were intended to provide for the care and maintenance of individuals by Hydra were used.
- Without proper documentation, or a formal quotation/tendering process, it is not possible to verify whether public monies were economically spent.
- It is unusual for a company to enter into an understanding with another company, for the provision of certain services, and then to pay the start up costs for that company.

Investigation of Allegations (Section 3.0)

Allegations

That Hydra accumulated surplus monies sourced from public funding (Section 3.4)

Conclusions

- In our opinion, by not having a SPA and by not effectively monitoring Hydra's use of public monies, the Department abdicated its responsibility to ensure that public monies were used for the purposes intended.

Specific Issues Concerning Department Funding of Hydra (Section 4.0)

Topics

Deficit relief funding provided to Hydra for the year ending March 31, 2002 when Hydra achieved a year end surplus. (Section 4.1)

Conclusions

- In our opinion, it was inappropriate for the Department and the WRHA to provide a for-profit external service provider with deficit relief funding for one segment of its operations, while the for-profit external service provider generated a significant surplus from other provincial monies.
- The actions taken by Hydra during the year ended March 31, 2002, provide an example of how decisions made by a for-profit company may not always be aligned with the economical and effective use of public monies intended for delivery of social services when the parties have not entered into a formal, documented understanding of how surplus and deficit situations should be addressed, as well as what are appropriate levels of overhead costs. Such decisions should be made within a framework of an appropriate return and salary level to the owners of for-profit external service providers significantly supported or economically dependent on public funding.
- We believe a goal of the public sector when providing funding of this nature should be to ensure that the funds are substantially used for the purposes intended, which is to provide for the direct care and maintenance of the children and adults under the care of external service providers. If there are surplus funds leftover, it would be appropriate that these funds be additionally used to improve the living conditions of the children and adults in care or provide for additional facilities for other children and adults needing this specialized care.

Specific Issues Concerning Department Funding of Hydra (Section 4.0)

Topics

Per diem funding for vacant spaces/downsizing was not adjusted when the number of spaces were reduced leading to Hydra accumulating surplus funds. (Section 4.2)

Funding of 7th placements at Hydra children's facilities contributed to Hydra accumulating surplus funds. (Section 4.3)

Conclusions

- Because the ASB did not request the necessary financial and staffing information from Hydra for the operations of two adult facilities, the ASB was not in a position to make an informed decision regarding whether an adjustment to the per diem rates for the remaining residents of these facilities was necessary.
- In our opinion, per diem rates that generated surplus funds totaling \$181,000 were not related to the cost of service. This represented between 14% - 23% of total program funding for the year ending March 31, 2002 and included \$100,600 for vacated spaces due to the downsizing of the two adult facilities.
- In our opinion, the per diem rates for these two facilities resulted in Hydra being able to accumulate surpluses before income taxes in excess of \$500,000 over the five year period of our review.

Review of the Department's Financial Accountability Relationship with External Service Providers (Section 5.0)

Topics

External service provider financial accountability (Section 5.1)

Conclusions

- The main purpose of an SPA is to ensure the responsibilities of both parties are clearly defined and understood. Having a signed SPA in place with each external service provider is a very important and fundamental element in ensuring appropriate service provider financial accountability for in excess of \$54 million dollars of public monies provided annually to approximately 50 external service providers.
- The difficulties experienced by the Department over the last number of years in negotiating SPAs with its external service providers may be an indication that some external service providers are not accepting their shared accountability for the use of public monies.

Review of the Department's Financial Accountability Relationship with External Service Providers (Section 5.0)

Topics

Conclusions

Per diem funding models (Section 5.2)

- The absence of signed SPAs creates an undue risk that the roles and responsibilities of each party may not be fully understood and agreed upon; that monies may not be directly used for purposes intended; and that all external service providers may not be treated equitably with an appropriate accountability agreement in place.

External service provider reporting requirements (ARR) and Department analytical review procedures (Section 5.3)

- Due to the inaccurate cost components in the CPSS funding model, such as in the area of salaries and benefits, and the absence of a funding model being used by the ASB, neither area of the Department are in a position to effectively measure an external service provider's financial performance, or to assess whether the external service providers are spending the money for the purposes intended.
- In our opinion, an external service provider's ability, such as in Hydra's case, to accumulate significant surpluses, is also indicative of the Department's need to review their funding models.
- Given that CPSS and ASB have not established a benchmark as to the acceptable level of administration and central costs that an external service provider can allocate to programs, there is a risk that external service providers may be incurring excessive administration and central costs.
- The analytical review procedures performed by CPSS and ASB on an external service provider's audited financial statements are not, in all instances, adequate to determine whether funded external service providers are spending public monies for the purposes intended.
- By not following up on required reports, nor reassessing the need for those or other reports on a regular basis, the Department may be exposing itself to the risk that it is not receiving appropriate information to enable it to effectively monitor spending of public monies by external service providers.

Review of the Department's Financial Accountability Relationship with External Service Providers (Section 5.0)

Topics

Comparison of not-for-profit and for-profit external service provider financial accountability requirements (Section 5.4)

Basis of accounting and reporting requirements for external service providers (Section 5.5)

Conclusions

- Based on our analysis of Hydra spending and differing financial accountability requirements, the risk of funds being spent for purposes other than direct client care may be higher when funding a for-profit external service provider as opposed to a not-for-profit external service provider. The reporting requirements and the degree of control exercised by the Department are greater over the not-for-profit external service providers than over the for-profit external service providers.
- The instructions for the preparation of the annual audited financial statements of external service providers are communicating an accounting treatment contrary to GAAP, and contrary to Regulation 17/99. The Department has specified a unique accounting treatment that will result in all audited financial statements of external service providers receiving a reservation in their auditor's opinion for their fiscal years ending March 31, 2004.
- By not receiving salary information from external service providers, the Department exposes themselves to the risk that public monies provided may be funding salaries in excess of what the Department would consider is reasonable for staff of an external service provider.
- A standard chart of accounts aligned with the various funding model cost components used by CPSS and ASB would help to facilitate external service provider reporting and also performance measurement procedures by CPSS and ASB.
- By not ensuring that external service provider annual audited financial statements include the requested statement of administration and central support costs, CPSS and ASB are not monitoring the appropriateness of the level of non-direct care expenses.

Review of the Department's Financial Accountability Relationship with External Service Providers (Section 5.0)

Topics

External service providers with multiple sources of public funding (Section 5.6)

Conclusions

- An external service provider's entire operations may not be subject to a thorough review in those instances where an external service provider, such as Hydra, receive funding from various divisions of the Department and from other provincial government agencies.

Our detailed recommendations are provided in Section 6.0.

1.0 Introduction

1.1 REQUEST

The Office of the Auditor General (OAG) reviewed a number of allegations concerning the operations of Hydra House Ltd. (Hydra), a recipient of public monies. Hydra is a for-profit, privately owned corporation that is economically dependent on provincial funding.

These allegations highlighted issues of:

- Hydra executive salaries/bonuses higher than the norm for other organizations providing similar services;
- Inappropriate use of public monies for personal purposes by Hydra executives;
- Payments to personal acquaintances of the owner of Hydra where there was no visible function of these persons within the organization; and
- Accumulation of surplus monies sourced from public funding.

On June 18, 2003, letters were provided to the owner of Hydra and to the Deputy Minister of the Department of Family Services and Housing (Department) confirming that the OAG planned to investigate these allegations. Section 15(1) of The Auditor General Act permits the Auditor General to perform an examination and audit in respect of a recipient of public money.

Section 10(2)(d) of The Auditor General Act indicates that the Auditor General must bring to the attention of the Legislative Assembly any instances where public money was expended for purposes other than those for which it was appropriated by the Legislature. It should be noted, that the allegations specifically highlighted the inappropriate use of public monies. The allegations did not highlight concerns regarding the quality of residential care. Our concerns with the allegations were that if proven true, such spending could have inappropriately reduced public monies available to provide additional, direct client care services in Manitoba.

1.2 SCOPE

Investigation of Allegations (Section 3.0)

This investigation was conducted between June 2003 and March 2004, and included interviews and meetings with the owner of Hydra, current and former Hydra staff, Department staff, and representatives of other organizations that provide similar services as Hydra. As well, financial information was analyzed, and relevant financial statements, correspondence, agreements and other supporting documentation were reviewed. Our work consisted of such examinations and procedures that we determined were necessary to address the allegations raised, and to address other issues that arose during the course of our work. We reviewed documentation and information primarily for the period from April 1, 1997 to March 31, 2002.

As a result of incomplete supporting documentation encountered in some areas, we were unable to investigate all expenses to the extent we believe appropriate.

Our investigation did not include an assessment of the quality of care provided by Hydra. However, general discussions with staff of the Department and other government agencies that provide funding to Hydra indicated that they were generally pleased with the quality of care being provided by staff of Hydra.

Review of Specific Issues Concerning Department Funding of Hydra (Section 4.0)

During our review of the allegations, other specific Hydra funding issues came to our attention. As a result we reviewed the following:

- Deficit relief funding provided to Hydra for the year ending March 31, 2002 (Section 4.1);
- Per diem funding to Hydra for vacant spaces (Section 4.2); and
- Funding of 7th placements at Hydra children's facilities (Section 4.3).

Review of the Department's Financial Accountability Relationship with External Service Providers (Section 5.0)

In addition to a review of the allegations and Hydra specific issues, we reviewed the following:

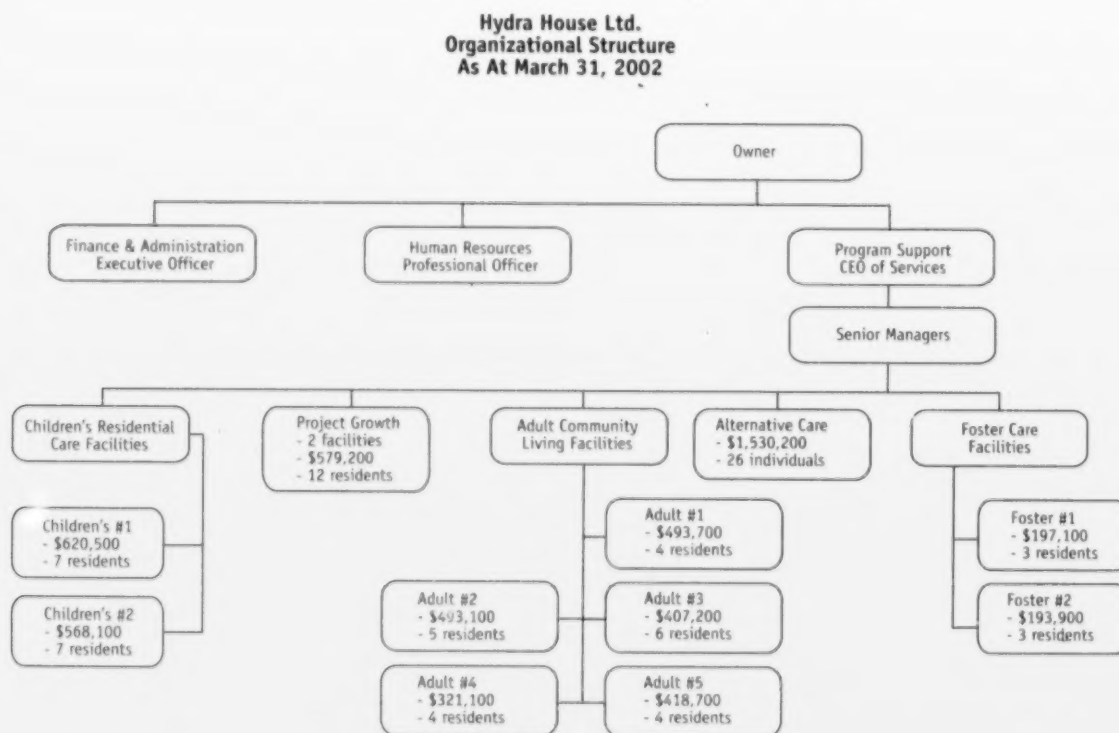
- The Department's external service provider financial accountability framework requiring the negotiation of service purchase agreements (SPA) with its external service providers (Section 5.1);
- Funding models used to establish or negotiate the level of funding to external service providers for delivering specific programs or services on their behalf (Section 5.2);
- The Department's reporting requirements and analytical review procedures (Section 5.3);
- Not-for-profit and for-profit external service provider financial accountability requirements (Section 5.4);
- The basis of accounting and reporting requirements for external service providers (Section 5.5); and
- The situation where external service providers receive provincial funding from multiple provincial government sources (Section 5.6).

2.0 Background

2.1 HYDRA HOUSE LTD.

Hydra is a for-profit company, registered with the Companies Office of Manitoba since 1985. During the period under review Hydra operated 11 facilities (March 31, 2000 – 10) located throughout Winnipeg. In these facilities, Hydra provided a comprehensive range of community based programs and services to support people of all ages living with a disability. Hydra operated children's residential care, adult community living, and adult mental health facilities. Hydra also provided specialized foster care and alternative care services. During the year ending March 31, 2002, Hydra received provincially sourced funding for approximately 90 individuals; although not all of these individuals were funded for the entire year due to transfers to and from other facilities. Figure 1 is the organizational structure of Hydra and includes information on each of its facilities as at March 31, 2002.

FIGURE 1



2.2 HYDRA FUNDING

Figure 2 is a summary of Hydra's annual revenue as disclosed in its audited financial statements for the fiscal years ended March 31, 1998 to March 31, 2002.

FIGURE 2

Hydra House Ltd. Annual Total Revenues	
Fiscal Year Ended	Total Funding
March 31, 1998	\$3,469,100
March 31, 1999	\$3,899,600
March 31, 2000	\$4,463,700
March 31, 2001	\$4,971,500
March 31, 2002	\$5,822,800

Source: Hydra audited financial statements.

As noted in Figure 2, total public funding to Hydra increased by 67.8% over the five year period. This increase resulted mainly from Hydra's expansion in Alternative Care services (foster and other programs) and the opening of another adult community living facility during the year ended March 31, 2001.

Figure 3 below illustrates Hydra's specific public funding sources for the two years ended March 31, 2001 and March 31, 2002.

FIGURE 3

Hydra House Ltd. Sources of Public Funding		
	March 31	
	2001	2002
Department of Family Services and Housing	\$3,781,200	\$4,036,200
Winnipeg Child and Family Services	351,000	777,200
Winnipeg Regional Health Authority	366,500	423,800
Employment and Income Assistance	115,600	106,600
Public Trustee	8,900	8,900
First Nations Child and Family Services Agencies	296,300	268,400
Other Agencies	52,000	201,700
	<u>\$4,971,500</u>	<u>\$5,822,800</u>

Source: Hydra House Ltd. general ledger for the years ended March 31, 2001 and March 31, 2002

Hydra received approximately 70% of its revenue from the Department, 13% from Winnipeg Child and Family Services and 7% from the Winnipeg Regional Health Authority for the year ending March 31, 2002. Other sources of public funding, making up the remaining 10% included Employment and Income Assistance, Public Trustee, First Nations Child and Family Services Agencies, and some other Agencies.

The sources of Hydra's publicly funded revenues and the programs where this funding was allocated for the year ended March 31, 2002, is illustrated in Appendix A.

Hydra funding was provided for the following purposes:

- The Department, through two of its branches, Child Protection and Support Services (CPSS) and the Adult Services Branch (ASB), provided per diem and other funding for children's residential care, adult community living, adult mental health or Project Growth, foster care, and alternative care services (foster and other programs);
- Winnipeg Child and Family Services provided funding mainly for the provision of foster care services under the alternative care program operated by Hydra;
- Winnipeg Regional Health Authority provided per diem and other funding mainly for the adult mental health program referred to as Project Growth;
- Employment and Income Assistance and Public Trustee provided funding for board and room with care to individuals of Hydra's Project Growth program, in accordance to the level of care rates as outlined in the Social Allowances Regulation. Since this funding may not be sufficient to cover the costs of care for some high needs individuals, supplemental funding is also available from other programs administered by the Department and the Winnipeg Regional Health Authority;
- Three First Nations Child and Family Services Agencies provided per diem and other funding for children's residential care and/or alternative care services (foster and other programs); and
- Other Agencies provided funding mainly for alternative care services (foster and other programs).

2.3 HYDRA OPERATING RESULTS

Figure 4 highlights Hydra's operating surplus (deficit) before income taxes for the five year period up to March 31, 2002. Hydra's unspent public monies for the five year period totaled \$479,500. This contributed to the build-up in Hydra's after-tax retained surplus which totaled \$1.3 million as at March 31, 2002. This surplus would be closer to \$800,000 if Hydra recorded accumulated amortization on capital assets. However, provincial reporting requirements requests that external service providers report without the recording of amortization on capital assets.

FIGURE 4

Hydra House Ltd. - Operating Results For the Years Ending March 31, 1998 to 2002						
	March 31					
	1998	1999	2000	2001	2002	Total
Operating income	\$3,469,100	\$3,899,600	\$4,463,700	\$4,971,500	\$5,822,800	\$22,626,700
Operating expenditures	3,268,100	4,063,900	4,218,800	4,937,700	5,658,700	22,147,200
Operating surplus/(deficit) before income taxes	\$ 201,000	\$ (164,300)	\$ 244,900	\$ 33,800	\$ 164,100	\$ 479,500

Source: Hydra House Ltd. audited financial statements

2.4 GOVERNMENT FUNDING

The Department Branches of CPSS and ASB provide funding to external service providers that operate residential care facilities for children and adults. As at March 31, 2002, while the majority of these external service providers were not-for-profit (approximately 46) there were 3 for-profit external service providers, including Hydra. Appendix B provides a listing of the monies that were distributed for the year ending March 31, 2002 from CPSS and ASB totaling \$54.8 million.

The Department and the other government agencies which fund external service providers have social workers and/or community service workers who regularly visit the children and adults under the care of these service providers to ensure that the basic needs of the children and adults are being met. Also, the Department issues licenses for these facilities, and regularly inspects each facility to ensure compliance with fire, safety, and health standards.

2.5 DEPARTMENT STRUCTURE

The Department is organized into five divisions:

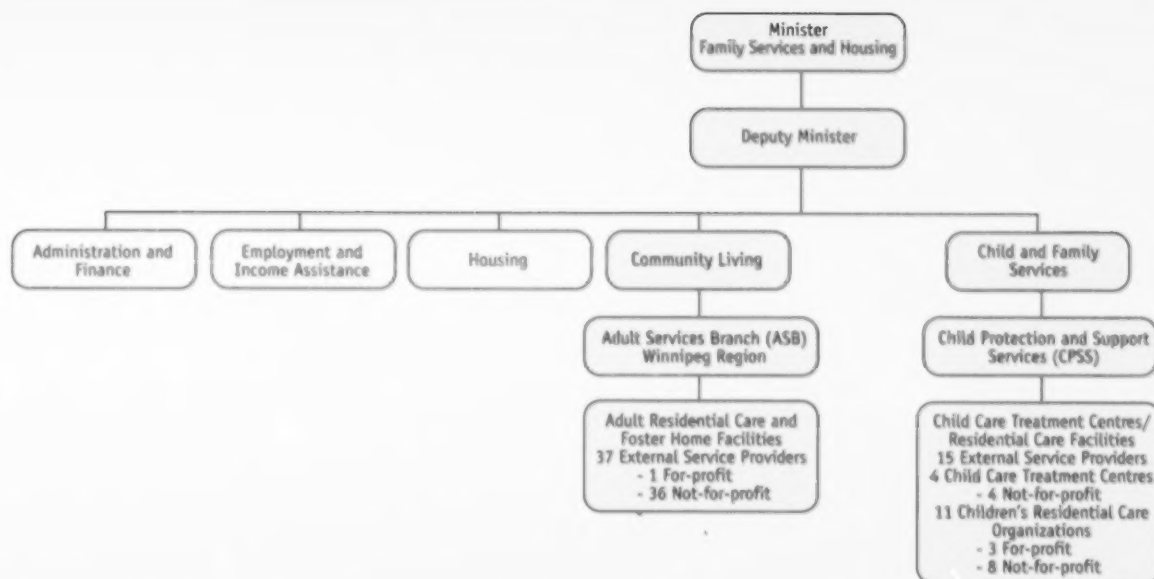
- Administration and Finance;
- Employment and Income Assistance;
- Community Living;
- Child and Family Services; and
- Housing.

The Department delivers services to the citizens of Manitoba through several networks of regional offices located throughout the province providing employment and income assistance and a range of social services.

As illustrated in Figure 3, the majority of the funding provided to Hydra is from the Department, through its CPSS and ASB branches. Consequently, our work in the area of agency accountability focused mainly on these two branches. Figure 5 below sets out the organization chart for the Department.

FIGURE 5

Department of Family Services and Housing
Organization Chart
As At March 31, 2002



Child and Family Services Division

The Child and Family Services Division is responsible for the delivery of social services to strengthen and support Manitoba families. As indicated in the Department Annual Report for the year ended March 31, 2002 the primary goal of the divisional programs is to support family unity. However, when families are unable to completely carry out their responsibilities, divisional programs provide for the protection and well-being of family members. When the rights of children and families are in conflict, the Child and Family Services Division ensures that the needs of children are met.

The funding of residential care facilities, such as Hydra, is provided by the Child Protection and Support Services (CPSS) section of the Child and Family Services Division. CPSS provides the program management and coordination for the Child and Family Service Division's core protection, emergency, crisis and related support services for children and families.

The stated objectives of CPSS are to:

- Plan and develop a comprehensive continuum of child and family services throughout the province designed to support, supplement and, where necessary, substitute for parental care; and
- Operate as a central directorate and provide administrative, program, and funding support to external agencies and regional offices to ensure the delivery of high quality services in accordance with provincial statutory requirements, policy direction, and budgetary allocations.

CPSS provided funding to child care treatment centres and residential care facilities, including 43 residential care facilities operated by 4 child care treatment centres and 11 other organizations. According to CPSS records approximately \$13,476,900 of funding was provided to these 15 organizations for child residential care support for the year ended March 31, 2002. Hydra, being one of the 11 other organizations, operated 2 child residential care facilities and received approximately \$986,600 for that year (see Appendix B).

Community Living Division

The Community Living Division is responsible for the coordination, direction and support for adult community living and vocational rehabilitation programs, the Manitoba Development Centre, regional delivery of social services, and residential care licensing.

The Adult Services Branch (ASB) of this Division is responsible for the planning, development, and funding of programs and services to enhance the quality of life of adults with disabilities living in the community and to support the achievement of their personal goals.

The stated objectives of the ASB, as outlined in the Department Annual Report for the year ended March 31, 2002, are to:

- Facilitate the development and delivery of residential, day, and support services for adults with a mental disability, including protection;
- Assist adults with a mental, physical, psychiatric or learning disability to prepare for, obtain and maintain employment through vocational assessment, planning, training, education and support services;
- Develop policies and programs which are responsive to the changing needs of the individuals being served;
- Provide assistance and guidance to service providers for the delivery of quality services for individuals;
- Provide and monitor funding to service providers that deliver services to individuals; and
- Provide training and development opportunities for staff of the Department and agencies to ensure a qualified workforce.

The services and programs delivered through the ASB are delivered mainly through 8 regional offices and over 100 external service providers. As of March 31, 2002, there were 37 external service providers, including Hydra, providing adult residential services for the Winnipeg Region. Our review focused on the ASB Winnipeg Region (ASB). In total, these external service providers received approximately \$41,283,700 in funding from ASB for the year ending March 31, 2002 (see Appendix B). Hydra received approximately \$3,049,600, according to ASB records.

2.6 WINNIPEG CHILD AND FAMILY SERVICES

For the year ended March 31, 2002, Winnipeg Child and Family Services (WCFS) provided funding of approximately \$5,900,000 to a number of external service providers for the provision of foster services. Of this amount approximately \$777,200 was provided to Hydra.

2.7 WINNIPEG REGIONAL HEALTH AUTHORITY

For the year ended March 31, 2002, the Winnipeg Regional Health Authority (WRHA) provided funding of approximately \$423,800 to Hydra, most of which was for a program called Project Growth – providing services to mentally challenged adults.

2.8 APPLICABLE LEGISLATION

The Department is authorized to license external service providers under various sections of legislation depending on the nature of the services to be provided. Hydra provides foster, child and adult care services on behalf of the Department. Applicable legislation concerning the licensing of these various facilities and inspection provisions have been summarized as follows:

- Section 8(1) of The Child and Family Services Act indicates that no person shall operate a foster home without a license for the purpose from an agency issued in accordance with the regulations.
- Section 3(1) of the Foster Homes Licensing Regulation (18/99) under The Child and Family Services Act indicates that a person may, in the form approved by the director, apply to the licensing agency for a license to operate a foster home.
- Section 8(4) of The Child and Family Services Act indicates that no person shall operate a child care facility other than a foster home without a license for the purpose from the director issued in accordance with the regulations.
- Section 4(1) of the Child Care Facilities (Other than Foster Homes) Licensing Regulation (17/99) under The Child and Family Services Act indicates that a person may, on a form provided by the director, apply for a license to operate a child care facility.
- Under Section 9 of The Vulnerable Persons Living with a Mental Disability Act, the minister may provide or arrange for the provision of support services for a vulnerable person. Section 10(1) of this Act indicates that the minister may make grants or payments to, purchase services from, or enter into agreements with persons, or organizations to provide support services for vulnerable persons under such terms and conditions as the minister considers appropriate.
- Under 4(2)(a) and (b) of The Child and Family Services Act, the Director of the Department may:
 - 4(2)(a) enter and inspect the premises of an agency, a child care facility or other place where a child is placed under this Act;

- 4(2)(b) inspect and obtain a copy of any record, paper or thing, or a sample of any material, food, medication, or thing that, in the opinion of the director, relates to an agency, a child, a child care facility, or to any matter being investigated by the director and that is in the possession or under the control of an agency or person in charge of any place mentioned in clause (a).
- Under 10(3) of The Vulnerable Persons Living with a Mental Disability Act, the minister may request an auditor, who may be the Auditor General to examine and audit the documents required to be kept under clauses 10(2)(a) and (b) and to report to the minister. These clauses state the following:
 - A person or organization that receives a grant or payment or enters into an agreement under subsection (1) shall: (a) keep accounting records and financial statements respecting the grant, payment or agreement, in such form and for such periods of time as the minister may require; (b) keep such records and such statistics and prepare such information respecting the programs, policies or procedures of that person or organization pertaining to support services as the minister may require; and (c) upon request, provide to the minister (i) the accounting records and financial statements referred to in clause (a), certified by an auditor, and (ii) the records, statistics and other information referred to in clause (b).

Part I - Hydra Allegations

3.0 Allegations

3.1 EXECUTIVE SALARIES AND OTHER PAYMENTS

ALLEGATION #1: Hydra executive salaries/bonuses higher than the norm for other organizations providing similar services.

Findings

- Hydra executive consisted of three positions during 1997 to late fall 2001. In November 2001, a further position was added to the executive group.
- Figure 6 is a summary of the salaries and other payments made to the Hydra executive, including the personal assistant to the owner.

FIGURE 6

Summary of Salaries and Other Payments to Hydra House Ltd. Executives For the Calendar Years 1997 to 2002							
	1997	1998	1999	2000	2001	2002	Totals
Reported on Hydra T4 as taxable	\$ 445,500	\$ 473,900	\$ 533,100	\$ 676,200	\$ 513,900	\$ 588,100	\$3,230,700
Not reported on Hydra T4 as taxable:							
Bonuses and other payments	-	65,200	156,700	12,800	-	-	234,700
Consulting fees to owner	-	147,000	19,700	59,300	-	180,000	406,000
Totals	\$ 445,500	\$ 686,100	\$ 709,500	\$ 748,300	\$ 513,900	\$ 768,100	\$3,871,400

Consulting fees are reflected in the above summary in the year expensed by Hydra House Ltd.
Source: Hydra House Ltd. payroll and accounting records

- The consulting fees of \$406,000 were charged to salaries expense and adjusted to the payable to shareholder account. We were not able to obtain any documentation identifying the type of consulting work that was performed. We were informed that an amount of \$180,000 was recorded for the year ending March 31, 2002 to reduce Hydra's taxable income. Consulting fees to the owner are in addition to the salary paid to the owner.
- For the six year period ending December 31, 2002, over \$3.8 million was paid in salaries, bonuses, and consulting fees to up to four Hydra executive positions, plus the personal assistant to the owner.

- In contrast, the senior executive position at a comparable not-for-profit, publicly funded, external service provider was compensated at approximately \$80,000 for the year ended March 31, 2003. If Hydra had compensated five executive positions over a six year period at a salary of \$80,000, approximately \$2.4 million would have been paid in salaries.
- Hydra's total salaries and benefits for the year ended March 31, 2002 for all staff, including executives, totaled approximately \$3,455,000. Executive salaries and benefits were approximately \$683,300, or almost 20% of Hydra's total salaries and benefits, with most of the remaining \$2,771,700 being directly related to the care and maintenance of the children, foster children and adults under the care of Hydra, with the exception of Hydra administrative and clerical staff salaries and benefits.
- Executive salaries and benefits as a percent of total Hydra funding for the year ended March 31, 2002 was approximately 11.7%.
- Figure 7 highlights Hydra's total expenditures by type for the two years ended March 31, 2001 and March 31, 2002. Hydra's annual audited financial statements included a statement of surplus/(deficit) for each of the Centres/Programs (Programs) that it operated. For the year ended March 31, 2002 there were 12 such statements, that when combined, reflected the total expenditures of Hydra before income taxes. Hydra did not have a separate statement disclosing administrative expenditures.
- Payroll expenses and care costs from Hydra's audited financial statements for March 31, 2001 and March 31, 2002, have been disclosed in more detail in Figure 7 to provide additional information.

FIGURE 7

Hydra House Ltd. Combined Statement of Operations Provincial Funding and Expenditures For The Years Ended March 31, 2001 and 2002		
	March 31	
	(as restated) 2001	2002
Operating Income	\$4,971,500	\$5,822,800
Operating Expenditures:		
Payroll expenses	\$2,483,500	\$2,771,700
Executive salaries and benefits	677,000	683,300
Foster fees	554,800	810,000
Care costs	187,200	252,700
Senior manager meals and entertainment	2,200	7,700
Executive meals and entertainment	19,000	25,200
Repairs and maintenance	198,600	210,800
Professional fees	189,100	161,500
Transportation	97,900	131,200
Rent	26,500	91,000
Utilities	65,600	76,500
Interest on long-term debt	46,200	59,900
Telephone, fax and internet	46,400	59,500
Office	70,000	55,400
Capital asset purchases	98,900	51,700
Principal repayment of long-term debt	21,500	45,600
Property taxes	36,600	41,600
Insurance	35,500	36,600
Training	32,200	34,900
Workers compensation	15,400	17,200
Equipment rental	14,400	16,700
Donations	2,500	5,000
Advertising and promotion	2,600	4,700
Interest and bank charges	12,200	3,500
Travel	1,300	3,100
Dues and memberships	600	1,700
Total Operating Expenditures	\$4,937,700	\$5,658,700
Operating Surplus before Income Taxes	\$ 33,800	\$ 164,100

Source: Hydra House Ltd. audited financial statements and financial records

- Hydra financial statements do not include a separate statement for administrative expenditures. Administrative expenditures are allocated to the various Programs operated by Hydra and are included in each of the 12 separate program statements. For example, the \$683,300 amount for executive salaries and benefits was allocated based on the number of clients in each Program. Therefore the payroll expenses disclosed on the various Program statements, for the year ended March 31, 2002, include executive salary and benefit allocations ranging from 12.1% to 34.0% of the payroll expense amounts disclosed on each Program statement.
- Our review of the chart of accounts guidelines issued by the ASB indicates they recommend that external service providers include a separate statement of administration and central supports costs in their financial statements.

- According to Hydra management they have included an administration and central support schedule in its financial statements for the year ended March 31, 2003. We reviewed the schedule; however, because it was outside the period of our review we did not verify that the extent of the administration expenses disclosed was complete and fairly presented.
- During the course of our review we noted that bonuses and other payments in excess of \$234,700 paid to members of the Hydra executive were not reported to Canada Customs and Revenue Agency (CCRA) on Hydra T4 information slips.
- In addition, a number of other Christmas bonus payments of \$1,000 and \$1,275 each were made to some administrative and senior Hydra staff in 1998 and 1999. A further bonus amount of \$5,000 was paid to a senior Hydra staff in September 1999. These payments were also not reported to the CCRA on Hydra T4 information slips.

Conclusions

- *We estimate that the salaries paid to Hydra executives over six years were approximately \$1.4 million (58%) higher than would have been paid had the programs been operated by not-for-profit external service providers. As there is no documented rationale in the Province's funding formula for these higher costs, it is impossible to judge whether they are appropriate.*
- *By not preparing the combined administrative costs, including the executive salaries, on a separate administrative statement or at least disclosing the extent of the administrative costs contained within each program statement readers of these statements did not have the necessary information to determine what the actual direct costs were to operate the various Programs. Had the Department formally requested and received a separate statement of Hydra's administration and central support costs, the Department may have become aware of the fact that executive salaries and bonuses were significantly higher than in not-for-profit external service providers.*
- *By not including all remuneration paid to its employees in the years 1998, 1999 and 2000 on the T4 information slips, Hydra was not in compliance with The Income Tax Act of Canada.*

3.2 USE OF PUBLIC MONIES BY EXECUTIVES

ALLEGATION #2: Inappropriate use of public monies for personal purposes by Hydra executives.

3.2.1 Hydra Credit Cards

Findings

- Figure 8 highlights corporate credit card transactions for Hydra executive (including the personal assistant to the owner) and senior managers. The total corporate credit card payments made by Hydra for the period under review was approximately \$521,100.

FIGURE 8

Summary of Hydra House Ltd. Credit Card Transactions Incurred by Executive and Senior Managers For the Fiscal Years Ended March 31, 1998 to 2002						
	March 31					Totals
	1998	1999	2000	2001	2002	
Senior Managers						
Meals and entertainment	\$ 500	\$ -	\$ 700	\$ 2,200	\$ 7,700	\$ 11,100
Vehicle	2,000	2,600	4,700	6,400	11,600	27,300
Residences	12,600	20,400	21,100	25,700	27,000	106,800
Office administration	1,900	1,200	4,900	8,500	11,200	27,700
Total	\$ 17,000	\$ 24,200	\$ 31,400	\$ 42,800	\$ 57,500	\$172,900
Executive						
Meals and entertainment	\$ 14,500	\$ 14,900	\$ 17,100	\$ 19,000	\$ 25,200	\$ 90,700
Vehicle	6,200	4,000	6,800	12,700	22,100	51,800
Residences	20,800	12,600	20,700	14,800	29,300	98,200
Office administration	6,500	6,100	16,700	39,200	39,000	107,500
Total	\$ 48,000	\$ 37,600	\$ 61,300	\$ 85,700	\$115,600	\$348,200
Total Credit Card Transactions						
Meals and entertainment	\$ 15,000	\$ 14,900	\$ 17,800	\$ 21,200	\$ 32,900	\$101,800
Vehicle	8,200	6,600	11,500	19,100	33,700	79,100
Residences	33,400	33,000	41,800	40,500	56,300	205,000
Office administration	8,400	7,300	21,600	47,700	50,200	135,200
Total	\$ 65,000	\$ 61,800	\$ 92,700	\$128,500	\$173,100	\$521,100

- Vehicle includes gas, insurance and repairs.
- Residences includes household charges, food, clothing, supplies, furniture, repairs and gifts.
- Office administration includes office supplies, equipment, cell phones, staff training, travel and other expenses.
- Credit card expenditures incurred by the personal assistant to the owner are included with the Executive charges in Figure 8.

Source: Hydra House Ltd. corporate credit card statements

- Credit card charges incurred by the executives, the personal assistant to the owner, and the senior managers included charges for various purposes as outlined in Figure 8.

- As a result of supporting documentation not being available for our review the scope of our investigation was limited and we were unable to investigate all expenses to the extent we believe appropriate. Additional items may have been reported if all the supporting documentation would have been available to us for review.
 - Approximately 20% of the receipts and/or invoices to support the credit card transactions incurred by the executive, the personal assistant to the owner and the senior managers were not available for our review.
 - Many of the corporate credit card transactions incurred by the executives were supported by the credit card slip only and did not include an invoice or sales receipt indicating what items were purchased or whether the item was purchased for a specific resident or facility.
- For the period of our review, no formal review or approval process was in place for executive and senior management credit card transactions. We were informed that Hydra did not have a formal policy over the use of the corporate credit cards.
- As well, there was no formal policy in place over meal and entertainment charges. However, Hydra management indicated that the informal guideline followed by the executive and senior managers was that the persons attending the lunch/dinner could be co-workers or clients, and that the lunch/dinner needed to be business related. On occasion Hydra would cover the cost of staff dinners at a higher end restaurant as a reward for a job well done. For the five year period under review, Hydra executive and senior managers incurred meal and entertainment expenses of approximately \$101,800.
- We followed up on certain credit card transactions totaling approximately \$164,200, not including meal and entertainment charges, with staff that had incurred these expenditures and examined receipts where available. The results of our review of these transactions was as follows:
 - Approximately \$83,700 (51 %) of the credit card transactions selected for follow up appeared to be a business expense.
 - Approximately \$34,100 (21 %) of the credit card transactions selected for follow up could not be distinguished as either a personal or business expense due to the lack of supporting documentation, and the Hydra staff member that incurred the expenditure could not recall the nature of the expense.
 - Approximately \$37,200 (23 %) was spent on items of a personal nature or was spent for purposes other than for the direct care and maintenance of Hydra's residents. We included in this amount expenditures for the following purposes:
 - Flight costs for personal purposes, incurred by the owner;

- Senior managers buying each other gifts, and gifts for Hydra executive. Individually, these items were usually under \$100;
- Hydra executive buying each other, and other Hydra staff, gifts and flowers. Individually, these items were usually under \$150, however there were some higher value items purchased such as a set of golf clubs and a television set;
- Personal clothing, cigarettes and other miscellaneous personal items for some Hydra executives;
- Hydra executive buying tickets for the Winnipeg Symphony Orchestra, the Royal Winnipeg Ballet, the Manitoba Theatre Centre, Celebrations Dinner Theatre, Paddlewheel River Rouge, and other events purchased through Select-a-Seat or Ticket Master. These tickets were used by Hydra executive and staff. We were told by Hydra executive that some tickets may have been used by Hydra staff with clients, however due to the lack of documentation available for our review we were unable to confirm this. We did not include ticket purchases for the Manitoba Moose and the Winnipeg Goldeyes as personal related expenses since many of these tickets were for the use of Hydra residents and some family members of residents; and
- Food and Manitoba Liquor Control Commission charges for Hydra staff functions.
- Approximately \$7,600 (4 %), of credit card expenses, were incurred in Florida by the owner and his personal assistant. Most of these expenses were for furniture, equipment, office supplies, and internet charges related to the owner's office in his vacation home.
- Another Hydra executive incurred credit card expenses of approximately \$1,600 (1%) over a two week period on a trip to the owner's vacation home office. We were advised by the executive member, that this trip was at the request of the owner and the purpose of the trip was to provide the owner with an update on Hydra's operations during the time the owner was in his vacation home office.
- For the year ended March 31, 2002, approximately \$32,900 or 11.5% of public monies disclosed as "program care costs" on Hydra's audited financial statements were spent on meals and entertainment expenses incurred by executive and senior managers of Hydra and was not directly related to the care and maintenance of the children, foster children and adults. The total care costs as reflected in Hydra's audited financial statements for the year ended March 31, 2002 were approximately \$285,600.
- A former Hydra executive member incurred meal and entertainment charges of approximately \$27,900 over a three year period from April 1,

1997 to March 31, 2000. This executive member averaged between 14 and 17 restaurant charges each month. The meal and entertainment charges incurred by this executive member represented between 55% and 63% of the total meal and entertainment charges incurred in total, by all Hydra executives and senior managers over this three year period.

- In addition to the meal and entertainment charges of approximately \$27,900 incurred by this former executive member on his corporate credit card, approximately \$16,500 of additional charges were processed through petty cash by this individual and charged to food costs in Hydra's accounting records over the three year period. The petty cash charges included pizza deliveries to the personal address of this individual, anywhere from 2 to 14 times each month, numerous fast food charges each month, and numerous charges at health food product retailers. According to Hydra's audited financial statements for the year ended March 31, 2000, the total food costs were approximately \$136,300, which included all the facilities operated by Hydra, and the meal and entertainment costs incurred by the executive and senior managers, in that year. The food charges incurred by this former executive through his corporate credit card and petty cash, for the year ended March 31, 2000, amounted to approximately \$16,200 or almost 12% of Hydra's total food expenditures in the year.
- After the departure of the previously noted executive member, the meal and entertainment charges, incurred by Hydra executives through their corporate credit cards increased over the next two fiscal years, as indicated in Figure 8.
- Hydra management indicated to us that any personal items incurred on the corporate credit cards should have been included on the T4 information slip of the respective employee. However, management further advised us that this process was not monitored closely during the period of our review. We noted exceptions where expenses for personal items were charged to salary expense, but were not included on the T4 information slip of the employee. In the case of the owner we were advised that any personal items incurred on his corporate card should either be on the T4 information slip of the owner or charged against the payable to shareholder account. Some exceptions to this practice were also noted.
- During our investigation, Hydra management indicated to us that they are in the process of developing formal policy and procedures over credit card usage.

Conclusions

- *We are concerned with the identifiable extent of public monies used for meal and entertainment charges (\$101,800) and other personal expenses of Hydra executive and staff (\$46,400) for the period March 31, 1998 to March 31, 2002, and not used for the direct care and maintenance of the residents. As a result of limited documentation provided for our review, we*

are unable to definitively quantify the extent. As there is no documented rationale in the Province's funding formula for the incurrence of these types of costs, it is impossible to judge whether they are appropriate.

- *It is misleading to include executive and senior manager meal and entertainment costs in a category of "program care costs" in financial statements provided to the Department. Funders of these programs may be assuming that all care costs are directly incurred for the benefit of residents.*
- *The practice of not retaining supporting documentation for corporate credit card expenditures, and the lack of any formal review and approval of these transactions is inappropriate and demonstrates a lack of due care over the management of public monies. Given that the Department has combined rights under The Child and Family Services Act and The Vulnerable Persons Living With a Mental Disability Act to review accounting and other records of external service providers, Hydra has not complied with the intent of the these Acts that financial accountability documentation be maintained.*
- *By not including all taxable benefits for its employees on the T4 information slips prepared for income tax purposes Hydra was not in compliance with The Income Tax Act of Canada.*

3.2.2 Other Transactions

Findings

- For the five year period under review, from April 1, 1997 to March 31, 2002, we selected approximately \$874,200 of expenditures for examination. We did not examine payroll, foster fee payments, credit card expenditures, rent, and other such expenditures in this section. Hydra was not able to provide us with supporting documentation such as invoices for all the transactions we intended to examine, amounting to approximately \$83,500. Additional items may have been reported in this section, had we been able to examine all of the requested documentation.
- For transactions of \$790,700 where we were able to examine documentation, we noted that approximately \$96,700 was charged to Hydra operations or recorded as a Hydra capital asset, but appear to be of a personal nature and were unusual given the nature of Hydra's operations as follows:
 - In August 1996, appliances totaling \$5,735 were purchased by the owner and delivered to the personal residence of another Hydra executive. In May and July of 1997, Hydra issued two cheques reimbursing the owner for this purchase;
 - In August 1996 Hydra entered into a 36 month lease agreement for a 1996 Audi Quattro. The monthly lease amount was \$799.44 including taxes. This vehicle was assigned to a former Hydra executive member and was leased for the full term. Hydra paid approximately \$28,800 for leasing this vehicle, of which \$22,400 was paid during the period of our review;

- From April 1997 to March 2002, Hydra paid the monthly phone rental and long distance charges for the personal residence of the owner, totaling approximately \$11,300. Included in this amount were long distance charges which amounted to approximately \$6,900, over the five year period. Most of the long distance charges related to calls to and from Florida;
 - From April 1997 to January 1999, Hydra paid the cable television charges for the personal residence of the owner, totaling approximately \$580;
 - In August and September 1997, Hydra purchased furniture in the amount of \$3,361 which was delivered to the personal residence of the owner;
 - In September 1998, Hydra issued a cheque in the amount of \$3,065 for the purchase of a television, a stand and two office chairs which were delivered to the personal residence of the owner;
 - From January 1999 to April 1999, Hydra issued four cheques totaling \$9,039 for the purchase of appliances and furniture which were delivered to the personal residence of the owner;
 - From August 1999 to March 2002, Hydra paid the cable television charges for the personal residence of a Hydra executive, totaling approximately \$1,400;
 - In September 1999, Hydra issued a cheque for \$1,096 to a trailer and camper repair company for the supply and installation of a toilet and awning on a trailer owned by the personal assistant to the owner;
 - In November 1999, Hydra issued a cheque in the amount of \$10,005 for the supply and installation of two commercial patio doors and frames for the personal residence of the owner;
 - In May 2001, Hydra paid an amount of \$3,961, charged to care costs, for an overseas trip on behalf of a Hydra employee and his spouse. According to Hydra management this was a reward to the employee for reaching twenty years of service;
 - In December 2001, an invoice was paid by Hydra which included furniture, amounting to \$2,326, for the personal residence of the owner;
 - In December 2001, an invoice was paid by Hydra in the amount of \$3,311 for the purchase of furniture and electronics which were delivered to the personal residence of a Hydra senior manager; and
 - From September 1997 to November 1999, donations were made to a private senior high school in Winnipeg totaling \$19,200.
- The owner of Hydra advised us that the purchase of furniture for his personal residence, using corporate funds, was done as a result of a

transaction that occurred prior to the period of our review. This transaction included the sale of the owners' personal residence at the time, to Hydra which then used the home as a foster care facility. In December 1996, a number of entries were posted to the payable to shareholder account, relating to this transaction, resulting in a net amount of \$117,634 being credited to this account. A credit to the payable to shareholder account represents a liability to Hydra. According to Hydra management, the owner had left most of the furniture when he sold the residence to Hydra and that new furniture purchased for his new residence, from Hydra funds, would offset the value of the furniture left with Hydra. Unfortunately, Hydra was not able to provide us with supporting documentation to enable us to verify the extent to which these transactions actually offset each other. We would have expected that the following documentation would have been available:

- An appraisal of the property being sold;
 - An appraisal of the furniture, purchased from the owner's personal funds, which was included in the property being sold;
 - Documentation to support the mortgage amount assumed by Hydra, relating to the property being sold; and
 - A detailed listing of the furniture purchased, from Hydra funds, for the owner's new residence.
- In the summer of 1999, two vehicles were purchased from Hydra by the owner and the personal assistant to the owner for \$8,000 each, according to bill of sale documents provided to us from Hydra. However, Hydra has not been able to provide us with documentation to indicate Hydra has received payment of these amounts from the owner and the personal assistant. Also, according to documentation we received from the Manitoba Public Insurance Corporation, at the time of the purchase, the average retail values for these two vehicles were \$20,000 and \$19,400. In 1995, Hydra had purchased these two vehicles, a 1993 Cadillac Seville STS for \$40,465 and a 1994 Cadillac Eldorado for \$42,275. From the time of the initial purchase, the vehicles were being driven by the owner and his personal assistant.
 - The CCRA rules concerning the personal use of a company-owned or leased vehicle state that if a company provides the owner, or any of its employees, with a vehicle for personal use, a taxable benefit has to be reported. This taxable benefit is comprised of two parts; a standby charge which reflects the personal access to the vehicle, and an operating benefit, which reflects the personal portion of operating expenses paid by the company. Employees are required to maintain accurate mileage records detailing the personal and business use of the vehicle to support the taxable benefit calculations. Hydra management confirmed that a taxable benefit was not calculated for the Cadillac vehicles or the leased Audi Quattro.

- A former Hydra executive member incurred charges through Hydra's petty cash, amounting to approximately \$25,500, over a three year period from April 1, 1997 to March 31, 2002. Of this total, approximately \$16,500 was charged to food costs in Hydra's accounting records, which we discussed in the previous section of this report. From our review of the remaining petty cash transactions, totaling \$9,000, we found approximately \$1,500 of charges which appeared to be of a personal nature and included personal clothing purchases, dry cleaning charges, driver's license fees, and magazine and other miscellaneous purchases. Many of the petty cash transactions incurred by the former Hydra executive member were supported by a credit card slip or debit card slip only, and did not include an invoice indicating what items were purchased. There was no documentation provided indicating that the item was purchased for a specific resident or facility. We were unable to investigate these expenses to the extent we believe appropriate.
- During the year ended March 31, 2002, an unsecured, non-interest bearing loan, due on demand of \$67,000 was advanced by Hydra to an arm's length company. In effect, public monies were advanced as a loan.
- None of the items identified in this section appear to have been included as a taxable benefit on the T4 information slips prepared by Hydra for the persons concerned. None of the above items, other than the sale of property transaction, were recorded through the payable to shareholder account.

Conclusions

- *We estimate that approximately \$98,200 of expenditures over five years appear to be of a personal nature, or was unusual given the nature of Hydra's operations, and was not used for the direct care and maintenance of the residents. As a result of limited documentation provided for our review, we are unable to definitively quantify the extent. As there is no documented rationale in the Province's funding formula for these higher costs, it is impossible to judge whether they are appropriate.*
- *A property sale transaction, from the owner to Hydra, was not recorded in an open and transparent manner.*
- *Hydra appears either not to have received appropriate compensation, for the sale of vehicles to the owner and the personal assistant to the owner, or alternatively, declared a taxable benefit for the transaction.*
- *By not including all taxable benefits for its employees on the T4 information slips prepared for income tax purposes Hydra was not in compliance with The Income Tax Act of Canada.*

3.3 PERSONAL ACQUAINTANCES AND RELATED PARTY TRANSACTIONS

ALLEGATION #3: That payments were made to personal acquaintances of the owner of Hydra where there was no visible function of these persons within the organization.

3.3.1 Personal Acquaintances

Findings

- Allegations were made that two personal acquaintances of the owner were being paid by Hydra despite having no function within the organization.
- We were able to determine that one of these individuals did have a visible function within Hydra. This was determined through our discussions with the individual involved, discussions with current and former Hydra staff, and through a review of records, correspondence and other documentation.
- Based on discussions with the second individual involved, discussions with current and former Hydra staff, and through a review of records and other documentation, we have summarized our findings as follows:
 - The current job title for this individual is personal assistant to the owner (personal assistant).
 - This individual indicated to us that he began working for Hydra on a part-time basis in 1982, working some night shifts at one of Hydra's group homes. During this time he was also a full-time employee of a Manitoba crown corporation.
 - Subsequent to his retirement from the crown corporation in the spring of 1996, he commenced full-time employment with Hydra as the personal assistant. There was no formal job competition for this position, and there was no contract or agreement signed between the two parties.
 - There is no formal job description for this position, performance appraisals are not completed, and the personal assistant does not have a Hydra business card. This position is not included on Hydra's current organization chart, or on any previous organization charts we examined.
 - The main duties of this position, according to the owner and the personal assistant, were to attend to the duties of the owner's office, which included survey work and research on policies and procedures. There were no regular or routine on-going duties assigned to the personal assistant.

- The personal assistant indicated the research duties he performed for the owner were confidential in nature and that most Hydra staff would not be aware of the work he did, and that he had no contact with Hydra staff other than some of the executive and on occasion a senior manager.
- We were advised by former Hydra staff that a committee, made up of executive and senior management, was set up in 1996 to overhaul Hydra's policies and procedures. However, the personal assistant was not part of this committee.
- The personal assistant indicated he worked out of his home when in Winnipeg and that he worked out of another location for the 4 to 5 months he spends each year in Florida.
- The personal assistant was not sure how many weeks vacation he earned each year and that he does not usually schedule vacation time or take vacation time. He referred to his time in Florida each year as a "working vacation."
- Hydra has supplied the personal assistant with a computer, office furniture and equipment, and office supplies for both of his work locations.
- We requested that the personal assistant provide us with some examples of the reports he has prepared related to the survey and research work he has performed during the five year period of our review. We subsequently received some documentation, from the personal assistant, most of which were financial related documents such as budgets and staffing schedules and budget summary forms.
- When asked about the duties of the personal assistant, one Hydra executive only knew that work was done by the personal assistant on behalf of the owner, and that on one occasion some typing was done by the personal assistant for this executive member.
- The personal assistant, when asked about certain expenditures incurred on his corporate credit card, indicated he also takes his, the owner's, and company vehicles for maintenance and washing on occasion and that he does some minor maintenance work on some of Hydra's residences.
- The salary paid to the personal assistant in 2002 was \$74,900. For the calendar years 1997 to 2002 the total salary and bonus payments to the personal assistant amounted to \$379,300; an average of \$63,200 annually.

Conclusions

- *In our opinion, the salary amounts paid to the personal assistant were not reasonable in relation to the duties performed.*

- *The salary of the personal assistant and the costs incurred to provide the personal assistant with office equipment and supplies for two locations, separate from the main office of Hydra, appear to be an unnecessary expense especially when considering that public monies which were intended to provide for the care and maintenance of individuals by Hydra were used.*

3.3.2 Related Party Transactions

Findings

- The spouse of a former Hydra executive received payments as employment income totaling approximately \$55,400 for the calendar years 1997 to 2000. As well, approximately \$95,700 for the years ending March 31, 1998 to March 31, 2001 was paid to a company owned by this spouse. These payments were for the provision of payroll and accounting services.
- The spouse of another Hydra executive received a payment of \$6,000 in November 1999 and then received monthly payments of \$5,000 made to his company beginning in January 2000 up to March 31, 2002, totaling approximately \$141,000. The spouse was listed as the President of this company and the Hydra executive was listed as a Director. This company, of which the spouse is the sole employee, provided human resource and recruitment services to Hydra. The initial payment of \$6,000 represented start-up costs for this company. Hydra had decided to utilize the spouse's services prior to the registration of his company.
- It appears that the above services were sole sourced, since no proposals for these services were sought from other suppliers. No formal agreements, contracts or job descriptions were in place to formally document the services to be provided. As such, we were unable to determine whether the payments support the services provided.
- Hydra management advised us that they do not have a conflict of interest policy in place at this time although they are considering development of a policy in the future.

Conclusions

- *Without proper documentation, or a formal quotation/tendering process, it is not possible to verify whether public monies were economically spent.*
- *It is unusual for a company to enter into an understanding with another company, for the provision of certain services, and then to pay the start up costs for that company.*

3.4 HYDRA FINANCIAL POSITION AS AT MARCH 31, 2002

ALLEGATION #4: That Hydra accumulated surplus monies sourced from public funding.

Findings

- As at March 31, 2002 Hydra's audited financial statements reflect a retained surplus of \$1.3 million. Retained surplus is reflective of a build up of equity consisting of capital assets and working capital. As at March 31, 2003 Hydra's retained surplus was \$1.7 million.
- It appears that surplus information is not used by the Department in assessing Hydra's continuing funding levels.
- The Department has not entered into a service purchase agreement (SPA) with Hydra (SPAs are discussed in Section 5.1 of this report). The deficit and surplus policy which is part of a SPA indicates that surpluses are retained by the external service provider. However, surpluses generated from Manitoba's contribution to services must be used for those services, and may only be used for other purposes with prior approval by Manitoba.
- Because Hydra has not entered into a SPA with the Department, Hydra does not solicit approval from Manitoba on the use of its surplus funds.

Conclusion

- *In our opinion, by not having a SPA and by not effectively monitoring Hydra's use of public monies, the Department abdicated its responsibility to ensure that public monies were used for the purposes intended.*

4.0 Specific Issues Concerning Department Funding of Hydra

During our review of funding provided by the Department to Hydra we noted some specific issues which are highlighted in the following sections.

4.1 DEFICIT RELIEF FUNDING PROVIDED TO HYDRA FOR THE YEAR ENDING MARCH 31, 2002 WHEN HYDRA ACHIEVED A YEAR END SURPLUS

Findings

- Hydra operates a program referred to as Project Growth which provides services to mentally challenged adults. This program has two residences, each with six bed units. The majority of funding for this program of approximately \$579,200 for the year ending March 31, 2002 was from the WRHA and ASB.
- During the year ended March 31, 2002, Hydra management advised officials of the WRHA and ASB of its intent to close the Project Growth program if funding to support the 12 residents was not increased and that Hydra was not prepared to continue operating the program at a loss.
- Subsequent to a number of meetings and a review of financial information prepared by Hydra management; officials of the WRHA and ASB agreed to provide Hydra with an additional amount of \$52,000 (WRHA - \$26,000; ASB - \$26,000) for deficit relief funding which was paid to Hydra in March 2002.
- The financial information prepared by Hydra and reviewed by officials of the WRHA and ASB related mainly to the operations of the Project Growth program, and not the overall financial operations of Hydra.
- For the year ended March 31, 2002, Hydra was projecting an overall operational surplus and recorded \$180,000 of consulting fees payable to the owner. Hydra management advised us that the additional expense of \$180,000 was recorded to reduce Hydra's reported operating surplus in order to take advantage of a lower corporate income tax rate.
- According to Hydra's audited financial statements for the year ended March 31, 2002, the overall surplus for the year was \$164,054 before income taxes. The overall surplus before income taxes would have been \$344,054 without the \$180,000 entry.
- The Project Growth program statement included in Hydra's audited financial statements for the year ended March 31, 2002 reported a deficit of \$104,417 after inclusion of the deficit relief funding of \$52,000, but before income taxes. The deficit of \$104,417 included an allocation of executive salaries and benefits totaling in excess of \$98,000, not including other administrative cost allocations.

- Hydra did not have an agreement with the WRHA or the ASB, nor a SPA. As mentioned in Section 5.1 of this report, SPAs between not-for-profit external service providers and the Department stipulate that deficits are not funded, and that surpluses can be retained by an external service provider. However, the external service provider must use any surplus funds generated from Manitoba's contributions for those services, as defined in a SPA, and may only use the surplus funds for other purposes with prior approval by the Department. Without a SPA in place, it appears that the Department provided deficit funding for Project Growth and did not seek input as to how Hydra's overall surplus funds generated from Manitoba's contribution for services were to be used by Hydra, such as establishing another children's or adult facility, or making capital repairs to existing facilities.
- Our discussions with Hydra management regarding the \$180,000 entry highlighted an important financial decision that Hydra considered in a year when it expected to earn significant profits. The \$180,000 reduced reported profits and resulted in a reduction in the corporate income taxes payable of Hydra. It was then able to take advantage of the lower small business corporate income tax rate. This occurred in the year March 31, 2002 when Hydra received deficit relief funding of \$52,000.

Conclusions

- *In our opinion, it was inappropriate for the Department and the WRHA to provide a for-profit external service provider with deficit relief funding for one segment of its operations, while the for-profit external service provider generated a significant surplus from other provincial monies.*
- *The actions taken by Hydra during the year ended March 31, 2002, provide an example of how decisions made by a for-profit company may not always be aligned with the economical and effective use of public monies intended for delivery of social services when the parties have not entered into a formal, documented understanding of how surplus and deficit situations should be addressed, as well as what are appropriate levels of overhead costs. Such decisions should be made within a framework of an appropriate return and salary level to the owners of for-profit external service providers significantly supported or economically dependent on public funding.*
- *We believe a goal of the public sector when providing funding of this nature should be to ensure that the funds are substantially used for the purposes intended which is to provide for the direct care and maintenance of the children and adults under the care of external service providers. If there are surplus funds leftover, it would be appropriate that these funds be used to improve the living conditions of the children and adults in care or provide for additional facilities for other children and adults needing this specialized care.*

4.2 PER DIEM FUNDING FOR VACANT SPACES/DOWNSIZING

As discussed in Section 5.2 of this report, there is no formal funding model used by ASB for the determination of per diem rates paid to external service providers operating adult community living facilities. We were advised by ASB staff that the per diem rates were determined on a case by case basis in conversation with the external service provider, and were based on the individual needs of the clients.

Findings

Adult Community Living Facility #1

- For the year ended March 31, 2002, Hydra operated 5 adult community living facilities which were funded primarily from ASB. The per diem rate from ASB was \$207.87 for each of the 6 residents at one of the adult facilities from April 1, 2001 until June 30, 2001. Effective July 1, 2001, the per diem rate per resident was increased by approximately 2% to \$212.03. Total funding amounted to \$39,437.58 ($\$212.03 \times 6 \times 31$) for the month of July 2001.
- Effective October 1, 2001 this adult facility was downsized from 6 to 4 residents.
- We examined the October 2001 billing invoice from Hydra to the ASB and found that the per diem rate for the remaining 4 residents was increased by \$53.01 bringing the per diem rate to \$265.04 for each resident. Also, on this invoice a vacant bed was funded at \$212.03 for 31 days. In total the October 2001 invoice amounted to \$39,437.89 which was basically the same amount received when the facility was funded for 6 residents in previous months.
- Effective November 1, 2001 the per diem rate for the remaining 4 residents was again increased by an additional \$53.01 bringing the per diem rate to \$318.05 for each resident, however there was no vacant space funded.
- To summarize, although the number of residents at this facility decreased from 6 to 4 the total funding from ASB did not decrease because of the increase in the per diem rate for the remaining 4 residents. Had the per diem rate remained the same, ASB would not have had to pay \$77,200 for the period October 1, 2001 to March 31, 2002.
- We were advised by ASB staff that total funding needed to remain the same since Hydra staffing levels were not to be changed as a result of the downsizing in order to ensure a safe environment at the facility.
- ASB staff did not perform any detailed financial analysis or request any financial projections from Hydra which would illustrate the expected operating results of the facility, and which would have provided necessary information to determine if the per diem rate needed to be adjusted.
- Although staffing levels were to remain the same, correspondence, dated March 2002, from a parent of a resident of this facility to ASB staff indicated concerns that actual staffing levels had not remained the same

since the downsizing and that the staff shortages had been going on for two months or longer.

- Further, our review of the payroll analysis prepared by Hydra indicated that direct service staff salaries charged to this facility amounted to \$236,500 (6 residents throughout the year) for the year ended March 31, 2001 and \$222,500 (downsized to 4 residents in October 2001) for the year ended March 31, 2002, which is a decrease of \$14,000 (5.9%). If staffing levels were the same we would have expected an increase in salaries from March 31, 2001 to March 31, 2002 due to annual general salary increases.
- Hydra staff indicated to us that the direct service staff salaries charged to this facility of \$236,500 for the year ended March 31, 2001 included additional staffing for day program and crisis support over and above the base residential staffing levels. This additional staffing was not required when the facility was downsized during the year ended March 31, 2002, and resulted in a decrease in salaries from March 31, 2001 to March 31, 2002.
- Our review of Hydra's audited financial statements for the year ended March 31, 2002 indicated this facility reported an operating surplus of \$113,100 for the year. ASB per diem funding for this facility was approximately \$493,600. Therefore, almost 23% of the per diem funding provided by the ASB ended up as surplus monies to Hydra for the year ended March 31, 2002. Executive salaries and benefits allocated to this facility was approximately \$32,700 for the year ended March 31, 2002.

Adult Community Living Facility #2

- Another adult facility operated by Hydra was downsized effective December 1, 2001 from 6 to 5 residents. There was no decrease in the overall funding of this facility because the per diem rate for the remaining 5 residents was increased to make up for the difference. The total per diem funding provided for this vacant space amounted to approximately \$23,400 of additional funding for the period December 1, 2001 to March 31, 2002.
- Our review of Hydra's audited financial statements for the year ended March 31, 2002 indicated this facility reported an operating surplus of approximately \$67,900 for the year ended March 31, 2002. ASB per diem funding for this facility amounted to \$493,000 therefore almost 14% of the per diem funding provided by the ASB ended up as surplus monies to Hydra for the year ended March 31, 2002. Executive salaries and benefits allocated to this facility was approximately \$40,800 for the year ended March 31, 2002.

Conclusions

- *Because the ASB did not request the necessary financial and staffing information from Hydra for the operations of these two adult facilities, the ASB was not in a position to make an informed decision regarding whether*

an adjustment to the per diem rates for the remaining residents of these facilities was necessary.

- In our opinion, per diem rates that generated surplus funds totaling \$181,000 were not related to the cost of service. This represented between 14% - 23% of total program funding for the year ending March 31, 2002 and included \$100,600 for vacated spaces due to the downsizing of the two adult facilities.*

4.3 FUNDING OF 7TH PLACEMENTS AT HYDRA CHILDREN'S FACILITIES

Findings

- The Provincial Placement Desk of CPSS controls the placement and level of care assessments for children in need of residential care treatment in the province.
- During the period of our review Hydra operated 2 children's facilities. For the year ended March 31, 2002 these 2 facilities received per diem funding for 7 residents each for most of the year. The majority of funding was from CPSS and was based on the level of care required (Levels III to V) and on the number of beds in each facility.
- All of the residents in the 2 children's facilities operated by Hydra were considered Level V which is the highest level of care and accordingly had a higher per diem rate. The per diem rate also varied depending on the number of beds in each facility. For example, for the year ended March 31, 2002 the Level V - 4 bed per diem was \$286.70, the Level V - 6 bed per diem was \$221.05, and the Level V- 8 bed per diem was \$187.52.
- The per diem rate for 13 of the 14 children in care was \$221.05; which is the per diem rate for the year ended March 31, 2002 for a Level V - 6 bed children's residential care facility (see Appendix C). The other resident in care, who reached the age of majority during the year, was funded from ASB at a per diem rate of \$220.48.
- Although each of the facilities had 7 residents for most of the year the per diem rate paid was based on 6 residents. As noted above, the per diem rate decreases as the number of beds (residents) increases according to the CPSS funding models.
- According to CPSS staff, Hydra was funded at the higher per diem rate of \$221.05 based on the 6 bed model because in total CPSS was only funding 12 residents (7 in one facility and 5 in the other facility) and thus were within the approved funding limit. The other two residents of the facilities were funded by other sources. One resident was funded from ASB for a portion of the year and the other resident was funded from Awasis Agency of Northern Manitoba which is a First Nations mandated agency which receives support funding from the Department.
- If the facilities were funded based on the number of residents in care regardless of which branch of the Department provides the funding, the

per diem rate could be less. Using the Level V- 6 bed and Level V - 8 bed funding models and prorating the difference in the per diem rates we estimated a per diem rate for a Level V - 7 bed would be approximately \$204.29. The additional funding provided to Hydra by using the higher per diem rate of \$221.05 was estimated to be in excess of \$40,000 for each of the 2 facilities or approximately \$80,000 in total.

- The reported surplus amounts before income taxes for the 2 children's facilities, according to the audited financial statements of Hydra for the year ended March 31, 2002, were \$53,200 and \$51,800 respectively. The 2 facilities would have incurred a surplus before income taxes of approximately \$13,200 and \$11,800 without the additional funding.
- The reported surplus amounts before income taxes were after the allocation of executive salaries and benefits of approximately \$57,000 to each facility.
- For the five year period of our review, the total surplus before income taxes amounted to \$193,400 and \$307,000 for these 2 facilities or approximately \$500,400 in total.

Conclusion

- *In our opinion, the per diem rates for these 2 facilities resulted in Hydra being able to accumulate surpluses before income taxes in excess of \$500,000 over the five year period of our review.*

Response from Hydra House Ltd.

As a result of the Auditor General's report and a meeting with the Assistant Deputy Minister for Family Services, as well as other government representatives, Hydra House Ltd. is engaging in a process with Family Services to resolve issues and concerns. We believe that a detailed response to the Auditor General's report is not the most effective approach in garnering resolution. Therefore, Hydra House Ltd. has chosen to take a direct approach and has initiated dialogue with Family Services to resolve the issues jointly and in a forthright manner,

PART II – Department Financial Accountability Framework

5.0 Review of the Department of Family Services and Housing's Financial Accountability Relationship with External Service Providers

5.1 EXTERNAL SERVICE PROVIDER FINANCIAL ACCOUNTABILITY

Findings

CPSS and ASB

- External service providers deliver services on behalf of CPSS and ASB. However, CPSS and ASB ultimately remain responsible for the nature and quality of services provided. Therefore, an effective external service provider financial accountability framework is an essential element of CPSS and ASB operations.
- An excerpt from the Introduction section of the ASB – Agency Reporting Requirements (ARR) indicates that – *"A large proportion of the budget allocated to the Community Living Division is paid to external agencies to provide services. These external agencies therefore share the accountability requirements placed on the Department of Family Services and Housing, Community Living Division, for the use of public funds".*
- The Department of Family Services and Housing's (Department) external service provider financial accountability framework requires the negotiation of an external service purchase agreement (SPA). The purpose of an SPA is to:
 - Clarify and improve the relationship between funded external service providers and the Department;
 - Set out the relationship between an external service provider's financial operations and its service delivery for the coming year; and
 - Achieve greater accountability by both parties.
- SPAs focus on the specifics of each external service provider's relationship with the Department, including their funding levels and their performance expectations.

- An SPA generally includes:
 - The term of the agreement;
 - A general description of the services to be provided;
 - Provisions for the inspection and audit of agency records by the Department;
 - Provisions for the termination of the agreement; and
 - Provisions which clarify the rights, responsibilities, relationships and expectations of the parties.
- Schedules and/or appendices also form part of an SPA and can be tailored to reflect differences in services provided by each external service provider. The schedules/appendices generally include the following:
 - A detailed description of the services to be provided, service goals and objectives, service outcomes, service administration and reporting, and service funding arrangements;
 - A deficit and surplus policy which indicates that deficits are not funded and surpluses are retained by the agency; and a stipulation that surpluses generated from Manitoba's funding of services must be used for those services, and may only be used for other purposes with prior approval by Manitoba;
 - Standard invoice outline for billing the Department for services provided;
 - Manitoba's conflict of interest policy and guidelines. In this schedule it is stated that Manitoba expects boards of directors and employees of external service providers which it funds to follow Manitoba's conflict of interest policy and guidelines;
 - Manitoba's confidentiality of information and protection of personal information requirements; and
 - External service provider reporting requirements (referred to by the Department as Agency Reporting Requirements or ARR) that set out the timing, content and format of the information to be reported by the external service provider to the Department.
- During our review we were advised by Department staff that certain elements of the SPA, such as the use of standard funding models and the ARR are applicable, whether or not signed SPAs are in place.
- In the summer of 1999, the OAG issued a report entitled, *Child, Family and Community Development Branch – Agency Accountability* (presently known as CPSS). This audit focused on assessing the effectiveness of the Branch's external service provider accountability framework. One of the findings included in this report was that there were no SPAs in place for almost 70% of the external service providers receiving funding from this Branch.

- For the year ended March 31, 2002, we found that 14 of the 15 external service providers (93%), including Hydra, did not have SPAs in place with CPSS. As well, for the year ended March 31, 2002, we found that 16 of the 37 external service providers (43%), including Hydra, did not have SPAs in place with ASB. This situation confirms that there was minimal action taken on the 1999 audit recommendation which stated, *"We recommend that Branch Management negotiate within a reasonable time period SPAs with all remaining agencies and that an implementation plan be developed"*.
- Department staff indicated that they have been trying, unsuccessfully, to negotiate SPAs with a number of the external service providers and that this process is on-going.
- According to CPSS records approximately \$13,500,000 of funding was provided to 15 external service providers, including Hydra, for child residential care support for the year ended March 31, 2002.
- According to ASB records approximately \$41,300,000 of funding was provided to 37 external service providers, including Hydra, for adult residential services in the Winnipeg Region for the year ended March 31, 2002.

WCFS

- For the year ended March 31, 2002, WCFS provided funding of approximately \$5,900,000 to a number of external service providers for the provision of foster services. Of this amount approximately \$777,200 was provided to Hydra for foster services. There were no SPAs in place between WCFS and the external service providers it funds, including Hydra.

WRHA

- Another of the programs operated by Hydra is referred to as Project Growth; which provides services to mentally challenged adults. Under the Project Growth program there are two residences, each with 6 bed units. The majority of funding for the Project Growth program was from the WRHA and ASB. There was no SPA in place between the WRHA and Hydra.

Conclusions

- *The main purpose of an SPA is to ensure the responsibilities of both parties are clearly defined and understood. Having a signed SPA in place with each external service provider is a very important and fundamental element in ensuring appropriate service provider financial accountability for in excess of \$54 million dollars of public monies provided annually to approximately 50 external service providers.*
- *The difficulties experienced by the Department over the last number of years in negotiating SPAs with its external service providers may be an indication that some external service providers are not accepting their shared accountability for the use of public monies.*

- *The absence of signed SPAs creates an undue risk that the roles and responsibilities of each party may not be fully understood and agreed upon; that monies may not be directly used for purposes intended; and that all external service providers may not be treated equitably with an appropriate accountability agreement in place.*

5.2 PER DIEM FUNDING MODELS

Funding models are used by the public sector to establish or negotiate the level of funding to external service providers for delivering specific programs or services on their behalf. Key input elements of funding models are expected service volumes, program service delivery standards, and cost expectations. It is imperative that the funding model be current and accurately reflect the costs an external service provider will incur to deliver the agreed upon programs or services on behalf of the government. The consistent application and use of standardized funding models helps ensure fair and equitable treatment of external service providers and establishes a benchmark for measuring their actual performance.

Appropriate funding models act as the connecting “bridge” between policy expectations and actual funding paid to external service providers. A line by line analysis of actual annual operating results to the funding model helps to identify issues regarding the adequacy of input elements in the funding models, as well as potential inefficiencies or uneconomical external service provider practices.

Findings – CPSS

- Children’s residential care facilities are funded based on the level of care required (Levels III to V) and on the number of beds (residents) in each facility. The per diem rates are calculated based on appropriate staffing, administration, shelter and care costs as determined by the Department. See Appendix C of this report for the detailed breakdown of the per diem rate schedule for a Level V – 6 bed facility that was in place for the year ended March 31, 2002.
- The per diem rates are approved each year through the Province’s estimates process. We were advised by CPSS staff that usually only the salaries and benefits categories of the per diem rate schedule change very much each year, while the other categories either remain the same or have only minor adjustments.
- CPSS staff indicated that the individual cost components of the per diem rate schedules no longer reflect actual current cost expectations for the services to be delivered, and that a line by line analysis of the funding model to actual costs incurred by external service providers would be meaningless. On the per diem funding model, the salaries and benefits component includes only basic and program staffing. Management fees are included with the administration component of the funding model.
- For example, we were advised that the salaries and benefits component of the per diem rate schedule is significantly higher than the actual salaries and benefits paid by the external service providers.

- A review of the Level V – 6 bed per diem rate schedule for the year ended March 31, 2002, used to fund Hydra operations indicated that the salaries and benefits component represents almost 84% (\$184.99/\$221.05) of the total per diem rate. Accordingly, the audited financial statements of Hydra for the year ended March 31, 2002, confirmed that the actual salary and benefit costs for the 2 Hydra children's facilities as a percentage of the total funding received was only 62% and 68% respectively. These percentages would even be lower, 52% and 58%, without the allocation of Executive salaries and benefits of approximately \$57,000 to each facility.
- CPSS staff indicated to us that other components of the per diem model such as food, insurance, utilities and taxes etc., are not sufficient to cover the actual costs of the external service providers. They also believe that the total overall per diem rate is appropriate even though the individual cost components are not. However, the audited financial statements of Hydra, reported that the 2 children's facilities had an operating surplus before income taxes of \$53,200 and \$51,800 respectively for the year ended March 31, 2002. For the five year period ended March 31, 2002, Hydra had operating surpluses before income taxes totaling \$500,400, for the 2 children's facilities.
- CPSS has an administrative component in their per diem model (\$6.90/\$221.05) or approximately 3%. However, as noted previously this might not reflect a realistic benchmark.
- We did not note any inconsistencies in the per diem funding rate provided to Hydra as compared to other service providers for the same required level of care.
- The Child and Family Services policies and procedures manual for CPSS indicates that funding models are to be reviewed on an annual basis. Although rates may have changed over the years, there has not been a comprehensive review of the funding model currently being used.
- In the summer of 1999, the OAG issued a report entitled, *Child, Family and Community Development Branch – Agency Accountability* (presently known as CPSS). This audit focused on assessing the effectiveness of the Branch's external service provider accountability framework. We recommended at that time, that the Branch review external service provider expenditures against approved per diem rates in an effort to determine whether the funding models used require update and revision. This recommendation was not acted upon by the Branch.

Findings – ASB

- There are no formal guidelines or funding model used by ASB for the determination of per diem rates paid to external service providers.
- We were advised by ASB staff that the per diem rates were determined on a case by case basis, and were based on the individual needs of the clients as proposed by the external service providers.

- Initially the per diem rates are reviewed by a community service worker. The proposed per diem rate is then reviewed by senior staff of ASB who either approve or request additional information from the external service provider. Once the negotiation process with the external service provider is completed, the per diem rate is formally approved by ASB and the external service provider uses this per diem rate to invoice ASB monthly for services provided to the individual client.
- We did not note any inconsistencies in the overall per diem funding rates provided to Hydra as compared to other similar external service providers providing the same level of care.
- ASB staff were unable to provide us with a detailed breakdown of the component costs which made up the per diem rates approved for a sample of 7 client's resident with external service providers during the period of our review.
- The audited financial statements of Hydra indicate that the 5 adult community living facilities had an overall operating surplus before income taxes of \$214,000 for the year ended March 31, 2002. For the five year period ended March 31, 2002, Hydra had operating surpluses before income taxes totaling \$317,400 for these 5 adult facilities.
- ASB staff indicated that they are currently in the process of developing formal guidelines which identifies cost components that could be used in establishing per diem rates for clients.
- Although per diem rates are negotiated with external service providers on a case by case basis, there is no overall benchmark used by ASB in considering the reasonableness of overall administration and central support costs incurred by an external service provider. As well, there is no defined basis for allocating such costs to funded programs that can be utilized by ASB in determining per diem rates when external service providers take on additional program responsibilities, or discontinue handling of a certain volume of clients.

Conclusions

- *Due to the inaccurate cost components in the CPSS funding model, such as in the area of salaries and benefits, and the absence of a funding model being used by the ASB, neither area of the Department are in a position to effectively measure an external service provider's financial performance, or to assess whether the external service providers are spending the money for the purposes intended.*
- *In our opinion, an external service provider's ability, such as in Hydra's case, to accumulate significant surpluses, is also indicative of the Department's need to review their funding models.*
- *Given that CPSS and ASB have not established a benchmark as to the acceptable level of administration and central costs that an external service provider can allocate to programs, there is a risk that external service providers may be incurring excessive administration and central costs.*

5.3 EXTERNAL SERVICE PROVIDER REPORTING REQUIREMENTS (ARR) AND DEPARTMENT ANALYTICAL REVIEW PROCEDURES

External service provider financial accountability can only be achieved when financial performance information is prepared, analyzed and acted upon. The Department should have processes in place to track the receipt of all required information and formal procedures, including penalties for non-compliance, to follow up information that has not been received.

Performance information prepared by external service providers should be reviewed and analyzed by the Department on a timely basis to determine whether expected results are being achieved.

It is imperative that the Department request from external service providers only that information it needs to perform these analytical review procedures. Financial information that will not be used or information that is forwarded to Department staff who do not review the information results in unnecessary time and costs being incurred by external service providers.

Findings

- The Department has documented their reporting requirements for external service providers in a document referred to as the Agency Reporting Requirements (ARR).
- The specific reporting requirements included in the ARR, that set out the timing, content and format of the information to be reported by the external service providers to the Department, are summarized in Figure 9.

FIGURE 9

Summary of External Service Provider Reporting - Agency Reporting Requirements (ARR)	
ARR I - Organizational Identifying Information	Requires reporting of information regarding the organization, board members, and senior staff of external service providers, including mission statements, program descriptions, and short and long-term operational plans.
ARR II - Annual Operating Budgets	- Sets out the requirement for reporting preliminary budgets for the next year by March 15; and finalized budget within 45 days of formal notification of annual funding levels. - Provides examples of reporting formats for budget information.
ARR III - Interim Reports	- Sets out the requirement for reporting interim results by the 25th of the month following the period being reported. - Provides examples of reporting formats for interim reports.
ARR IV - Audited Financial Statements	- Sets out the requirement for submission of audited financial statements within three months of the external service provider's year end. - Any management letters and suggestions to the external service provider from the auditor are required along with the audited financial statements. - Provides detailed descriptions of the main types of information to be included in the audited financial statements.
ARR V - Annual Reports	- Annual reports are required immediately following the year end or the external service provider's annual meeting. - If no formal report is prepared, the minutes of the annual meeting may be submitted in its place.
ARR VI - Supplementary Reports	- Requirement to submit staffing reports and units of service statistics along with the audited financial statements. - Provides the Department with authority to request additional information including details of staff benefits, utility costs, accounts receivable and payable listings, etc.

Findings - CPSS

- CPSS maintain an ARR control log to track the receipt of required reports, as set out in Figure 9, by external service provider.
- According to CPSS records, all 15 external service providers that received child residential care support for the year ended March 31, 2002 had submitted audited financial statements. However, the submission percentage of the 15 external service providers for the other required reports including identifying information, budgets, interim reports, annual reports and supplementary reports ranged from 7% to 27% only.
- CPSS has no formal policy and procedures for staff to follow when external service providers do not submit required reports, including penalty provisions for non-compliance.
- CPSS staff perform analytical review procedures on the audited financial statements received from external service providers which is documented on a standard analytical review procedures checklist.
- A significant procedure included on the CPSS checklist is for CPSS to compare actual operating results of the external service provider with their current year budget, prior year actual, and the funding formula. The intent of this procedure is to ensure that the external service provider is spending monies in accordance with CPSS requirements.

However, this procedure cannot be completed adequately due to the lack of a meaningful per diem funding model which could be used as a measurement tool, and due to the lack of budget information provided by external service providers.

- In most instances the analysis of income statement information is limited to confirming that the external service provider has completely recorded CPSS funding.
- During our review of the analytical procedures performed by CPSS staff, we noted that when an issue was identified, follow-up and resolution of the issue was not documented to confirm that action was taken.

Findings – ASB

- ASB does not maintain an ARR control log to track the receipt of required reports, as set out in Figure 9, by external service provider. However, ASB staff records the receipt of external service provider's audited financial statements.
- According to ASB records, 7 of the 37 external service providers (19%) that received funding for adult residential services in the year ended March 31, 2002 had not submitted audited financial statements.
- ASB has no formal policy and procedures for staff to follow when external service providers do not submit required reports, including penalty provisions for non-compliance.
- ASB staff were not able to provide us with any of the other reports including identifying information, budgets, interim reports, annual reports and supplementary reports required under the ARR.
- The ASB has no policy and procedures concerning analytical review procedures to be performed on audited financial statements received from external service providers.
- ASB staff indicated to us that other than compiling certain information from the external service provider's audited financial statements, there are no regular analytical review procedures performed on the external service provider's audited financial statements.

Conclusions

- *The analytical review procedures performed by CPSS and ASB on an external service provider's audited financial statements are not, in all instances, adequate to determine whether funded external service providers are spending the monies for the purposes intended.*
- *By not following up on required reports, nor reassessing the need for those or other reports on a regular basis, the Department may be exposing itself to the risk that it is not receiving appropriate information to enable it to effectively monitor spending of public monies by external service providers.*

5.4 COMPARISON OF NOT-FOR-PROFIT AND FOR-PROFIT EXTERNAL SERVICE PROVIDER FINANCIAL ACCOUNTABILITY REQUIREMENTS

Findings

- In Section 3.0 we highlighted a number of instances where, in our opinion, Hydra had expended publicly funded monies for purposes other than for the direct care and maintenance of the children and adults under the care of Hydra.
- We have summarized some of the similarities and significant differences between not-for-profit and for-profit external service providers in Figure 10 below. The Department should review and assess whether financial accountability requirements should be the same for all external service providers.

FIGURE 10

Financial Accountability Requirements		
	Not-for-Profit External Service Providers	For-Profit External Service Providers
• Service Purchase Agreements (SPA) in place.	Some*	No
• The Department has formal authority, under the SPA to audit and inspect external service provider financial records.	Some*	No
• Annual Audited Financial Statements required to be submitted.	Yes	Yes
• External service provider must use any surplus provincial funding for those services as defined in the SPA and may only use the surplus funds for other purposes with prior approval by the Department.	Some*	No - Department approval not required.
• Independent Board.	Yes - Accountability to community members and parents of facility residents.	No - Accountable to Owners.
• Senior Management Reporting.	To Board	To Owners
• Public Sector Compensation Disclosure Required for Annual Compensation Amounts Paid to its Officers and Employees in Excess of \$50,000.	Yes	No
• Must meet or exceed Manitoba's Conflict of Interest Policy.	Some*	No

*Not all not-for-profit external service providers have SPAs.

Conclusion

- *Based on our analysis of Hydra spending and differing financial accountability requirements, the risk of funds being spent for purposes other than direct client care may be higher when funding a for-profit external service provider as opposed to a not-for-profit external service provider. The reporting requirements and the degree of control exercised by the Department are greater over the not-for-profit external service providers than over the for-profit external service providers.*

5.5 BASIS OF ACCOUNTING AND REPORTING REQUIREMENTS FOR EXTERNAL SERVICE PROVIDERS

Findings

- As previously indicated, the Department has documented their reporting requirements for external service providers in a document referred to as the Agency Reporting Requirements (ARR). One requirement is the submission of annual audited financial statements by the external service provider to the Department.
- As per The Child and Family Services Act – Regulation 17/99 titled, Child Care Facilities Licensing Regulation Section 25 - Financial Records, “A licensee shall maintain complete and accurate financial records with respect to the operation of the child care facility in accordance with generally accepted accounting principles and shall make them available for inspection by the director on request”. In turn, this implies that financial information should be prepared and reported in accordance with generally accepted accounting principles (GAAP). Financial statements prepared in accordance with Canadian GAAP, is the accepted criteria used in Canada to determine whether financial statements are fairly presented.
- Upon review of the ARR requirements, we noted that they indicate that the audited financial statements of external service providers shall be prepared on the accrual method of accounting. However, the requirements further indicate that depreciation on capital assets is not recognized as an operating expense by the Department. The actual cost of replacing and/or maintaining these assets in the day to day operations of the external service provider is a recognized expense as are principal and interest payments on mortgages and loans. This is contrary to generally accepted accounting principles (GAAP). This also contradicts the previously noted regulation.
- The ARR indicates that external service providers in receipt of provincial funding have to disclose compensation to individuals of \$50,000 or more each year as required under The Public Sector Compensation Disclosure Act. However, the ARR does not specifically request that this information be provided to the Department. Further, for-profit external service providers do not have to provide this information under the Act. Had the Department obtained this information on salaries paid at Hydra, a timely discussion on the reasonableness of compensation paid may have taken place.
- ASB provide external service providers with a chart of accounts to be used for accounting and in preparing their annual audited financial statements. CPSS do not provide a chart of accounts to external service providers. CPSS staff indicated to us that while they would prefer that external service providers prepare their annual audited financial statements in accordance with the CPSS per diem funding model cost components; they do not formally request this of the external service providers.

- ASB requires that external service providers include a separate statement in their annual audited financial statements for administration and central support costs. ASB did not ensure that this was done by all external service providers. For example, this specific statement was not prepared and included as part of Hydra's annual audited financial statements for the period under review. Hydra included administration and central support costs in the costs of their various programs and, as such, this information was not transparent to the Department.
- CPSS has no requirement for inclusion of a separate statement of administration and central support costs in the annual audited financial statements of external service providers.

Conclusions

- *The instructions for the preparation of the annual audited financial statements of external service providers are communicating an accounting treatment contrary to GAAP, and contrary to Regulation 17/99. The Department has specified a unique accounting treatment that will result in all audited financial statements of external service providers receiving a reservation in their auditor's opinion for their fiscal years ending March 31, 2004.*
- *By not receiving salary information from external service providers, the Department exposes themselves to the risk that public monies provided may be funding salaries in excess of what the Department would consider is reasonable for staff of an external service provider.*
- *A standard chart of accounts aligned with the various funding model cost components used by CPSS and ASB would help to facilitate external service provider reporting and also performance measurement procedures by CPSS and ASB.*
- *By not ensuring that external service provider annual audited financial statements include the requested statement of administration and central support costs, CPSS and ASB is not monitoring the appropriateness of the level of non-direct care expenses.*

5.6 EXTERNAL SERVICE PROVIDERS WITH MULTIPLE SOURCES OF PUBLIC FUNDING

Findings

- External service providers may have multiple sources of public funding. Appendix A of this report highlights the various sources of public funding for Hydra.
- External service providers are able to access various types of funding from their funding sources, including per diem, special needs, crisis intervention, fostering, transportation, and day program funding.

- CPSS analytical review procedures performed on external service providers, such as Hydra, is usually limited to those segments of Hydra operations funded by CPSS, which are the two children's facilities. All the other facilities operated by Hydra, such as the adult community living facilities, may not be included in the CPSS review procedures.
- As discussed previously in this report, ASB staff do not perform regular analytical review procedures on the external service provider's audited financial statements, which they receive.
- WCFS does not request external service providers to submit audited financial statements, and accordingly no analytical review procedures are performed.
- Effective April 1, 2003 WCFS was dissolved and now operates as a branch of the Department. We were advised that the process of funding external service providers for the provision of foster services has not changed as a result of the reorganization.
- The WRHA funded Hydra on a per diem basis, however there was no funding model in place. The per diem paid by the WRHA was essentially the same amount paid since 1999 when the funding authority for Hydra was transferred from Manitoba Health to the WRHA. Additional funding was also provided to Hydra from the WRHA to cover special needs and day program costs for the residents.
- Although the WRHA received audited financial statements from Hydra there were no analytical review procedures performed on the financial statements.
- Effective April 1, 2003 the WRHA was no longer responsible for funding a portion of the Project Growth program of Hydra. The responsibility is now completely with ASB.

Conclusion

- *An external service provider's entire operations may not be subject to a thorough review in those instances where an external service provider, such as Hydra, receives funding from various divisions of the Department and from other provincial government agencies.*

6.0 Recommendations

FOR HYDRA

Given that Hydra is economically dependent on provincial monies:

- That Hydra reduce the use of public monies for personal purposes, and with direction from the Department follow reasonable salary and expense policies.
- That Hydra review all T4 submissions to ensure that all information has been completely and accurately reported to the CCRA.
- That Hydra develop a formal policy and procedures for meal and entertainment charges that would be acceptable to the Department.
- That Hydra develop formal policy and procedures over the use of corporate credit cards. At a minimum, the policy should include a formal review and approval process and the requirement that supporting documentation be maintained for all transactions.
- That Hydra financial statements include a separate statement of administrative expenditures in accordance with Department guidelines.
- That Hydra disclose meal and entertainment expenses separately as an administration expense and not as care costs under the various program statements in its audited financial statements.
- That Hydra retain all supporting financial related documentation in the future in accordance with legislation.
- That Hydra ensure that all transactions and agreements utilizing public monies be accurately and completely documented. In order to ensure that value for money is obtained for required services, tenders and/or quotes should be used, and documentation maintained.
- That Hydra complete the sale transactions of the two vehicles by arranging payment from the owner and the personal assistant to the owner in the amount of the retail value of the vehicles at the time of sale plus interest or declare the taxable benefit.

FOR THE DEPARTMENT

Given that Hydra receives significant public monies annually:

- That the Department seek legal advice and assess whether it can take action to recover public monies that were not used by Hydra to provide client care services in Manitoba.
- That in light of our findings, the Department review the level of funding provided to Hydra.
- That the Department consider surplus funds accumulated by Hydra in future funding decisions.

- That CPSS and ASB staff ensure that they have all the relevant financial information of Hydra that is required to better facilitate decision making when reviewing per diem rates and funding levels.

Given that External Service Providers receive substantial public monies annually:

Service Purchase Agreements

- That the Department establish target dates and implement Service Purchase Agreements (SPAs) with all funded for-profit and not-for-profit external service providers to reduce undue risk and ensure that public monies are utilized for the purposes intended.

Financial Accountability Requirements

- That the Department update its financial accountability requirements for both not-for-profit and for-profit external service providers, ensuring that all funded external service providers are equitably funded and monitored.
- That the Department reassess their reporting requirements from external service providers to ensure that they receive appropriate information to enable them to effectively monitor the spending of public monies by external service providers. This would include:
 - Updating the ARR to communicate that annual audited financial statements of external service providers should be prepared in accordance with GAAP;
 - Updating the ARR to request that each external service provider, whether for-profit or not-for-profit, submit an audited statement of compensation paid in excess of \$50,000 annually to the Department;
 - Requiring that external service providers submit administration and central cost details;
 - Developing formal procedures, for use by CPSS and ASB staff, to analyze information received and to follow up required information that has not been submitted by external service providers. The procedures could include penalty provisions for non-compliance by external service providers.
- That the Department formally assign responsibility to monitor and review the entire operations of those external service providers that receive funding from a number of sources. This review should include an analysis and the appropriateness of each type of funding received.
- That CPSS and the ASB develop appropriate funding models which can be used as an effective funding tool and measurement tool for evaluating actual external service provider performance. Formal policies should be in place to ensure that detailed reviews of the funding models are done at least every two to three years to determine that cost components are still realistic.

- That CPSS and ASB establish a benchmark as to the acceptable level of administration and central support costs that an external service provider should incur and allocate to funded programs. This could also involve the development of guidelines on travel, meals, and entertainment expenses, etc.

FOR THE WINNIPEG REGIONAL HEALTH AUTHORITY

Given that Hydra and other external service providers were funded by the Winnipeg Regional Health Authority (WRHA):

- That, in the future, the WRHA implement SPAs with any funded external service providers to reduce undue risk and ensure that public monies are utilized for the purposes intended.

7.0 Learning for Civil Servants

This investigation highlights the importance of ensuring that funded external service providers recognize that they too share in the responsibility for the appropriate use of public monies. As well, civil servants have a key role in ensuring that public monies are being directed toward the provision of public services. They must ensure that external service providers acknowledge that as the recipients of public monies, they share in this responsibility. This role may be compromised when resources within the Civil Service itself are constrained.

The lack of an appropriate financial accountability framework, including having SPAs in place, increases the risk that future problems can arise. Our investigation of Hydra illustrates this.

For Civil Servants, we recommend:

- That as custodians of public monies charged with funding social programs civil servants should ensure:
 - That financial accountability arrangements with external service providers are fully documented. This would take the form of a SPA; and
 - That there is documented understanding of how surplus and deficit situations should be addressed, and that they ensure that all relevant financial information is requested and provided by external service providers, when related decisions are required.

Response from Department

Family Services and Housing has reviewed and accepts the recommendations of the Office of the Auditor General (OAG). Outlined below is a brief response to the recommendations. The Department has developed a plan for immediate action to address many of the conclusions and recommendations of the OAG report. The Department has well developed program-based systems already in place to ensure the health and well-being of vulnerable adults and children placed in residential settings, including assessments and individual planning to ensure appropriate placements and in determining the necessary levels of funding, regular licensing inspections and on-site visits by trained staff. Our primary concern is that people with disabilities receive appropriate, quality care, and although the OAG review did not specifically include an assessment of care, it did not identify any significant service delivery issues. The Department recognizes the merit of reviewing the criteria under which funding for these services is determined.

The Department acknowledges that more must be done to improve financial accountability within its established external agency accountability framework. The Department has relied on audited financial statements to demonstrate the financial integrity of external agencies. However, it is clear that more information and analysis is required to ensure that the Department has a complete understanding of the disposition of public monies. Additional measures will be put in place to help ensure the appropriate use of public funds. Key elements of our action plan include strengthening the operation of the Department's external agency accountability framework. The Department recognizes that an effective framework includes Service Purchase Agreements (SPAs), which clearly define the terms and conditions for funding, including policies to address allowable administration costs and agency surpluses/deficits. The Department has been working to conclude SPAs with its external service partners. By the end of February 2004 over 90 per cent of the agencies that provide services for adults with mental disabilities through the Services for Persons with Disabilities Division had signed SPAs.

These SPAs must be accompanied by regular reporting by both not-for-profit and for-profit agencies. The Department will continue to impose the same accountability requirements on not-for-profit and for-profit agencies and put measures in place to ensure that the for-profit status of an agency does not conflict with the judicious expenditure of public funding. An important element of the accountability framework also includes board and agency development, to ensure that service providers clearly understand their roles and responsibilities with respect to the expenditure of public funds. The Department will immediately focus existing resources to enhance its agency accountability framework.

RESPONSE TO RECOMMENDATIONS

- *The Department has retained legal counsel and referred the OAG report to Civil Legal Services for review and advice on the potential to recover funds from Hydra House.*
- *The Department will undertake a review of the level of funding provided to Hydra House to ensure that it is appropriate.*
- *The Department will inform all external service providers that SPAs must be in place as a condition of ongoing funding and will develop a schedule for this purpose.*
- *The Department will establish a dedicated agency accountability function to strengthen management and control of funding to external agencies, including establishing SPAs where they do not already exist; approving all external agency contracts; ensuring agencies' financial performance is monitored; providing consultative assistance and training to departmental staff and agency boards to enhance effective management; and conducting special audits of external agencies.*
- *The Department will examine and update its funding models for external agencies and ensure the models are reviewed regularly to ensure they continue to be valid for determining funding levels, including establishing guidelines of acceptable levels for administrative and central support costs, as well as other costs not program related, that external service providers should incur. Funding models will also include policies to address the disposition of agency surpluses or deficits.*

Appendix A

Hydra House Ltd. - Sources of Public Funding								
	Department of Family Services and Housing		Other Sources of Public Funding					Total
	CPSS	ASB	WCFS	WRHA	E. & I.A./ Public Trustee	First Nations Mandated Agencies (3)	Other Agencies (3)	
Hydra House Ltd.								
Children's Residential Care Facilities								
Children's #1	\$ 440,300	\$ 60,600	\$ -	\$ -	\$ 5,900	\$ 95,300	\$ 18,400	\$ 620,500
Children's #2	546,300	-	21,600	-	-	-	200	568,100
Project Growth								
Program	-	26,000	-	26,000	-	-	-	52,000
2 Facilities	-	55,600	-	364,900	106,400	-	300	527,200
Adult Community Living Facilities								
Adult #1	-	493,600	-	-	-	-	100	493,700
Adult #2	-	493,000	-	-	-	-	100	493,100
Adult #3	-	407,000	-	-	-	-	200	407,200
Adult #4	-	321,000	-	-	-	-	100	321,100
Adult #5	-	417,800	-	-	-	-	900	418,700
Alternative Care	-	384,200	755,600	32,900	3,200	173,100	181,200	1,530,200
Foster Care Facilities								
Foster #1	-	197,000	-	-	-	-	100	197,100
Foster #2	-	193,800	-	-	-	-	100	193,900
TOTAL	\$ 986,600	\$3,049,600	\$ 777,200	\$ 423,800	\$ 115,500	\$ 268,400	\$ 201,700	\$5,822,800

Source: Hydra House Ltd. accounting records and audited financial statements

Appendix B

CPSS Funding to External Service Providers* For The Year Ended March 31, 2002			
	For-Profit	SPA	Funding
Child Care Treatment Centres			
1. New Directions for Children, Youth and Families Inc.	No	Yes	\$ 900,900
2. Knowles Centre Inc.	No	No	1,460,800
3. Marymount Inc.	No	No	2,399,900
4. Macdonald Youth Services	No	No	3,727,400
			8,489,000
Children's Residential Care Organizations			
1. Green Pastures Retreat Inc.	No	No	129,100
2. B&L Homes For Children Ltd.	Yes	No	1,117,300
3. Halldorsson Group Homes	Yes	No	349,800
4. Project Neecheewam Inc.	No	No	650,800
5. Jessie Group Home Inc.	No	No	337,300
6. Quest Group Home Services Inc.	No	No	452,900
7. Child and Family Services of Western Manitoba	No	No	544,600
8. Hydra House Ltd.	Yes	No	986,600
9. St. Amant Centre Inc.	No	No	206,200
10. Churchill Health Centre	No	No	20,800
11. Ndinawemaaganag Endaawaad Inc.	No	No	192,500
			4,987,900
			\$13,476,900
As At March 31, 2002			
3 - For-profit			
12 - Not-for-profit			
1 - SPA in place			
14 - SPA not in place			

Source: CPSS

* The external service providers included in this summary provide services to residents requiring various levels of care. The external service providers also operate varying numbers of residences and beds per residence.

Appendix B (cont'd.)

ASB (Winnipeg Region) Funding to External Service Providers* For The Year Ended March 31, 2002			
	For-Profit	SPA	Funding
1. Amba Inc.	No	No	\$ 193,500
2. Arcane Horizon Inc.	No	No	1,018,600
3. Community Respite Services Inc.	No	No	129,200
4. Com-Span Inc.	No	Yes	537,500
5. Covenant Home Inc.	No	No	152,800
6. Direct Action in Support of Community Homes Inc. (DASCH)	No	Yes	3,730,100
7. Dove Homes Inc.	No	Yes	223,400
8. Hope Centre Inc.	No	No	3,459,100
9. Hydra House Ltd.	Yes	No	3,049,600
10. Intervention Manitoba Inc.	No	Yes	566,300
11. Kaydee Homes Inc.	No	No	98,600
12. L'Arche Inc.	No	No	940,300
13. L'Avenir Cooperative Inc.	No	Yes	1,095,300
14. Le Coin Amitee Inc.	No	No	246,900
15. Luther Homes Inc.	No	No	185,300
16. Maitland B Steinkopf Residents Inc.	No	Yes	762,500
17. New Directions for Children, Youth and Families Inc.	No	No	6,163,600
18. Network South Enterprises Inc.	No	Yes	780,300
19. Norshel Centre Inc.	No	Yes	248,400
20. Oberlin House Inc.	No	Yes	118,700
21. Opportunities for Independence Inc.	No	No	1,337,700
22. Prairie Places Inc.	No	Yes	611,100
23. Pulford Community Services Inc.	No	Yes	1,650,500
24. St. Amant Centre Inc.	No	Yes	3,363,200
25. St. James Industries Inc.	No	Yes	123,300
26. The Salvation Army in Canada - Community Ventures	No	No	1,101,500
27. SCE Lifeworks Inc.	No	Yes	1,082,100
28. Shalom Residents Inc.	No	No	848,400
29. Simaril Housing Inc.	No	Yes	533,100
30. SPIKE	No	Yes	540,100
31. Stradbroke Optimist House Inc.	No	Yes	377,600
32. Transcona Springfield Employment Network Inc.	No	No	451,700
33. Versatech Industries Inc.	No	No	1,328,000
34. Visions of Independence Inc.	No	Yes	923,300
35. Work and Social Opportunities Inc.	No	Yes	790,800
36. Westwood Vocational Centre Inc.	No	Yes	96,400
37. Winnserv Inc.	No	Yes	2,424,900
			<u>\$41,283,700</u>
As At March 31, 2002			
1 - For-profit			
36 - Not-for-profit			
21 - SPA in place			
16 - SPA not in place			

Source: ASB

* The external service providers included in this summary provide services to residents requiring various levels of care. The external service providers also operate varying numbers of residences and beds per residence.

Appendix C

Children's Residential Care Facilities Salaries and Benefits 2001/02 Rate Computation - Level V - 6 Bed		
Chart of Accounts	Amount	Per Diem
Salaries	\$341,479	\$164.07
Staff benefits/levy	43,538	20.92
Total Salaries and Benefits	\$385,017	\$184.99
Shelter		
Domestic	\$ 119	\$.06
Household allowance	1,762	.85
Bedding and linen	315	.15
Rent/mortgage	5,703	2.74
Repairs, maintenance, replacement	10,950	5.26
Insurance	2,312	1.11
Utilities	7,146	3.43
Taxes	2,333	1.12
Total Shelter	\$ 30,640	\$ 14.72
Administration		
Advertising	\$ 384	\$.18
Accounting, audit, computer fees	2,701	1.30
Bank charges and interest	3,270	1.57
Management fee	6,013	2.89
Postage, stationery, supplies	92	.04
Staff training	1,408	.68
Telephone	431	.21
Other supplies and expenses	61	.03
Total Administration	\$ 14,360	\$ 6.90
Care		
Food	\$ 14,276	\$ 6.86
Health	271	.13
Clothing	3,787	1.82
Education	520	.25
Gifts	520	.25
Activities	3,746	1.80
Transportation	3,933	1.89
Personal allowance	2,997	1.44
Total Care	\$ 30,050	\$ 14.44
Grand Total	\$460,067	\$221.05
Days Care	2,081	
Capacity	2,190	

Appendix C (cont'd.)

Children's Residential Care Facilities Salaries and Benefits 2001/02 Rate Computation - Level V - 6 Bed			
	SY	SY Amount	Total Salary
Basic Staffing			
Youth Care worker III	1.00	\$40,481	\$ 40,481
Youth Care worker II	4.20	\$32,644	137,105
Youth Care worker II - relief	.50	\$32,644	16,322
Statutory holiday pay for relief			1,313
4% vacation pay for relief			705
Total basic salaries	5.70		\$195,926
Program Staffing			
Youth Care worker III	.50	\$40,481	\$ 20,241
Youth Care worker II	2.60	\$34,809	90,503
Youth Care worker II	1.00	\$34,809	34,809
Total program staff	4.10		\$145,553
Total Salaries			\$341,479
Staff Benefits/Levy			
C.P.P.			-
U.I.C.			-
Dental plan			-
Group Health Insurance			-
Group insurance		10.50%	35,855
Private pension plan			-
Workers compensation			-
Payroll tax levy		2.25%	7,683
Total Salaries and Benefits	9.80		\$385,017

Excerpt: The Auditor General Act

Audit of government accounts

9(1) The Auditor General is the auditor of the accounts of the government, including those relating to the Consolidated Fund, and must make any examinations and inquiries that he or she considers necessary to enable the Auditor General to report as required by this Act.

Audit of recipient of public money

15(1) The Auditor General may conduct an examination and audit in respect of public money received by a recipient of public money, including the matters listed in subsection 14(1), and may require the recipient to prepare and give to the Auditor General the financial statements setting out the details of the disposition of the public money received.

Audit of operations

14(1) In carrying out his or her responsibilities under this Act, the Auditor General may examine and audit the operations of a government organization with regard to any of the following matters:

- (a) whether financial and administrative provisions of Acts, regulations, policies and directives have been complied with;
- (b) whether public money has been expended with proper regard for economy and efficiency;
- (c) whether the Assembly has been provided with appropriate accountability information;
- (d) whether the form and content of financial information documents is adequate and suitable.

No obstruction

15(2) No person shall obstruct or provide false or misleading information to the Auditor General or a person employed under the Auditor General in conducting an examination or audit under this section, or conceal or destroy any records or things relevant to an examination or audit.

Access to information

18(2) The Auditor General may require and is entitled to receive any information necessary for the purpose of this Act from:

- (a) any person in the public service or formerly in the public service;
- (b) any current or former director, officer, employee or agent of a government organization or of a recipient of public money; or
- (c) any other person, organization or other body that the Auditor General believes on reasonable grounds may have information relevant to an examination or audit under this Act.

Content of the report

10(2) The report must indicate anything resulting from the work of the Auditor General that he or she considers should be brought to the Assembly's attention, including, but not limited to, circumstances in which:

- (a) required information was not provided or was not provided within a reasonable time;
- (b) accounts were not properly kept or public money was not fully accounted for;
- (c) essential records were not maintained, or the rules and procedures applied were insufficient, to
 - (i) safeguard and control public property,
 - (ii) secure an effective check on the assessment, collection and proper allocation of revenue, or
 - (iii) ensure that expenditures were made only as authorized;
- (d) public money was expended for purposes other than those for which it was appropriated by the Legislature; or
- (e) financial and administrative provisions of Acts, regulations, policies and directives were not complied with.

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